

Chapter 7

I. Graphing the Macroeconomy

II. Aggregate Demand

A. Components of AD: Consumers, Businesses, Government, the Foreign Sector

B. Aggregate Demand Has a Negative Slope

1. The Real Balance Effect (Assets/Wealth Effect)
2. The Interest Rate Effect
3. The International Trade Effect

C. Movements Along vs. Shifts in Aggregate Demand

1. Recall “change in the quantity demanded” vs. “change in demand”
2. Change in the quantity demanded of real GDP vs. change in Aggregate Demand
3. Only a change in the aggregate price level can move us from one point on a given Aggregate Demand function to another point on the same function. The items in “B” above all reflect impacts that result from changes in the price level.
4. Shifts in Aggregate Demand: Consumers, Businesses, Government, Net Exports
 - a. Consumption: Wealth, expectations, interest rates, income taxes
 - b. Investment: Interest rates, expectations, business taxes
 - c. Net exports: Foreign real national income, exchange rates

III. Short Run Aggregate Supply

A. Aggregate Supply Has a Positive Slope

1. Sticky wages
 - a. Nominal wages vs. real wages (firms hire based on real wages)
 - b. Long term labor contracts lead to increased short term profits.
2. Sticky prices: If aggregate prices rise and you do not raise your prices you will sell out your stock quickly and have to order/produce more.
3. Producer and worker misperceptions

B. Movements Along vs. Shifts in Short Run Aggregate Supply

1. Recall “change in the quantity supplied” vs. “change in supply”
2. Change in the quantity supplied of real GDP vs. change in SRAS
3. Only a change in the aggregate price level can move us from one point on a given Aggregate Supply function to another point on the same function. The items in “A” above all reflect impacts that result from changes in the price level.
4. Shifts in Aggregate Supply
 - a. Technology and productivity
 - b. Supply shocks (resource quantities, weather, trading partners...)
 - c. Resource Prices (wage rate, prices of nonlabor inputs)

IV. Short Run Macroeconomic Equilibrium

A. Equilibrium: the intersection of AD and SRAS

1. Quantity demand of RGDP equals quantity supplied of RGDP
2. Determines the equilibrium price level.

B. Disequilibrium: Any price level that is not the equilibrium price level will lead to surpluses or shortages that move prices up or down to the equilibrium level.

C. RGDP and the unemployment rate are inversely related, *ceteris paribus*.

D. Changes in AD or SRAS lead to changes in prices, RGDP and the unemployment rate.

V. Long Run Aggregate Supply (LRAS)

A. Defined as “the output the economy produces in the long run”: A vertical line.

B. Questions for future consideration: Pages 182-184.