Macro 4.4.4 test notes

Aggregate Demand and Supply: Aggregate demand is the total quantity of goods and services demanded by households, firms, foreigners, and government at varying price levels. A shift in the aggregate demand curve to the right is due to A cut in income tax rates. When the price level (inflation) increases interest rates rise because the real amount of money people want to borrow rises. When the economy is in a severe recession, an increase in aggregate demand will lead to a big increase in real GDP and a smaller increase in the price level. An increase in oil prices will shift the aggregate supply curve leftward. Aggregate supply increases when wage rates or interest rates decrease and the economy's price level remains unchanged. If oil firms find a new method for obtaining oil from dry and depleted oil fields the *AS* curve shift to the right. A decrease in *AS* affect nominal GDP will either cause an increase or a decrease. The aggregate demand curve shows the level of real GDP purchased in the economy at different possible price levels during a period of time.

***AD/AS* model** In the *AD/AS* model If the government cuts income taxes and the result is a big increase in output and a small increase in the price level, then at both the original and new economic equilibrium points the aggregate supply curve is relatively flat. In the *AD/AS* model short-run aggregate supply curve is vertical at the full-capacity level of real GDP. The *AS* curve becomes very steep, but not quite vertical when an economy approaches the full-employment level of RGDP. The aggregate supply curve has a significantly different curve or arc to it than the aggregate demand curve because as an economy gets closer to full production capacity, even small increases in production become very expensive, so prices have to rise much higher for each increase in production.

Inflation: The following is an effect of inflation a decrease in the aggregate quantity of goods and services demanded, increasing demand for the products of foreign countries, adecrease in the real value of household cash holdings, and an increase in interest rates. When inflation in the United States rises Americans tend to demand more foreign goods and services. Cost-push inflation will decrease output. Demand-pull inflation will cause wages to rise as the economy moves toward long-run equilibrium.

Stagflation the unemployment rate is high and the inflation rate is high. If Mexico is the most important trading partner of the United States, stagflation in Mexico will have an indeterminate effect on aggregate demand in the U.S. Stagflation is caused a decrease in aggregate supply.