Unit 6, Lesson 38

Activity 1

Introducing Aggregate Demand

The aggregate demand (AD) curve shows the total amounts of goods and services that consumers, businesses, governments, and people in other countries will purchase at each and every price level. It represents all the demand in the economy.

The aggregate demand curve looks a lot like a demand curve for a single product. However, there are big differences. The vertical axis is labeled "Price Level." The price level is a measure of the average weighted price of all goods and services. An increase in the price level indicates inflation. A decrease in the price level indicates deflation.

The horizontal axis is labeled "Real GDP." It represents the value of all final goods and services produced, adjusted for inflation. Think of real GDP as the quantity of the nation's output.

The AD curve is downward-sloping. This means that consumers, businesses, governments, and people in foreign countries together will buy more goods and services at a lower price level than they will at a higher price level.

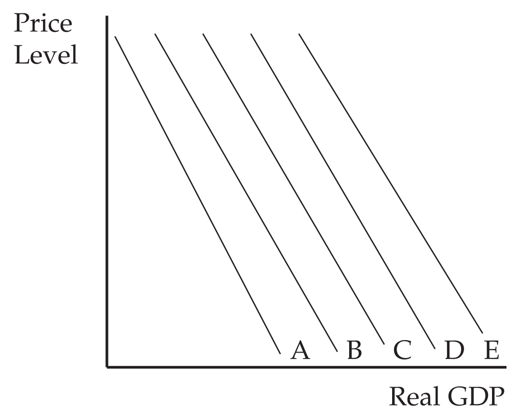
Shifts in Aggregate Demand

Shifts in aggregate demand show the effects of events and government policies on the price level and real GDP. Anything that causes an increase in consumer, business, or government spending, or in net exports, will increase AD. For example, higher incomes increase consumer spending and therefore increase AD. More business investment increases AD. Higher government spending increases AD. If U.S.-made goods and services become more desirable in other countries, AD increases. Anything that decreases consumer, business, or government spending, or net exports, will decrease AD. If higher taxes decrease people's net income, AD decreases. If business profits are down, businesses may invest less, and AD decreases. If government spending decreases, AD decreases. If U.S.-made goods and services are selling less in other countries, AD decreases. Expectations of change also affect AD. For example, if consumers feel there is going to be a recession soon, they may save more and spend less. This behavior decreases AD.

Analyzing events that affect aggregate demand is easy. The key is spending. Now see if you can analyze how events shift the AD curve.

For each situation described below, determine whether the event will increase or decrease AD. Start with AD curve *C*. If you think the first situation would increase AD, write "increase" and move to curve *D*. If you think the first situation would decrease AD, write "decrease" and move to curve *B*. Move only one curve at a time. Do not skip a curve even if you think the situation will cause a huge increase or decrease in AD. If you think an event will not cause AD to shift, write "no change." Do not go beyond the five curves. If you need to go beyond the five curves, you need to rethink your answer!

Shifts in Aggregate Demand



1. Congress cuts taxes.

   AD__________________ Curve_____________

2. A survey shows business investment spending decreased last month.

   AD__________________ Curve_____________

3. Government spending will increase next fiscal year; the President promises no increase in taxes.

   AD__________________ Curve_____________

4. A survey shows consumers are confident about the future economy.

   AD__________________ Curve_____________

5. Business leaders feel the economy is headed for recession.

   AD__________________ Curve_____________

6. The stock market collapses — investors lose billions.

   AD__________________ Curve_____________

7. Productivity rises for the fourth straight year.

   AD__________________ Curve_____________

8. The President cuts defense spending by 20 percent; there is no increase in domestic spending.

   AD__________________ Curve_____________