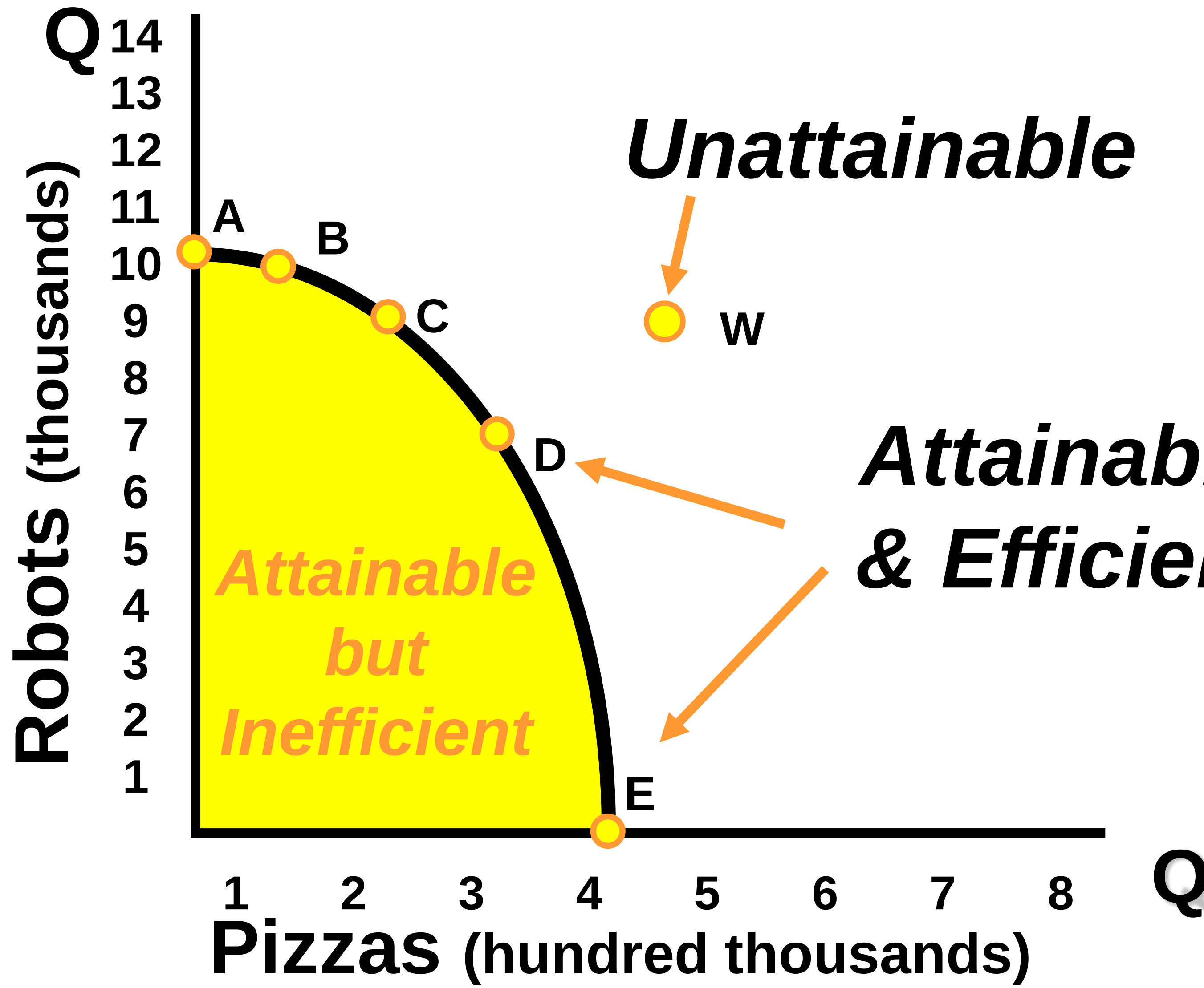
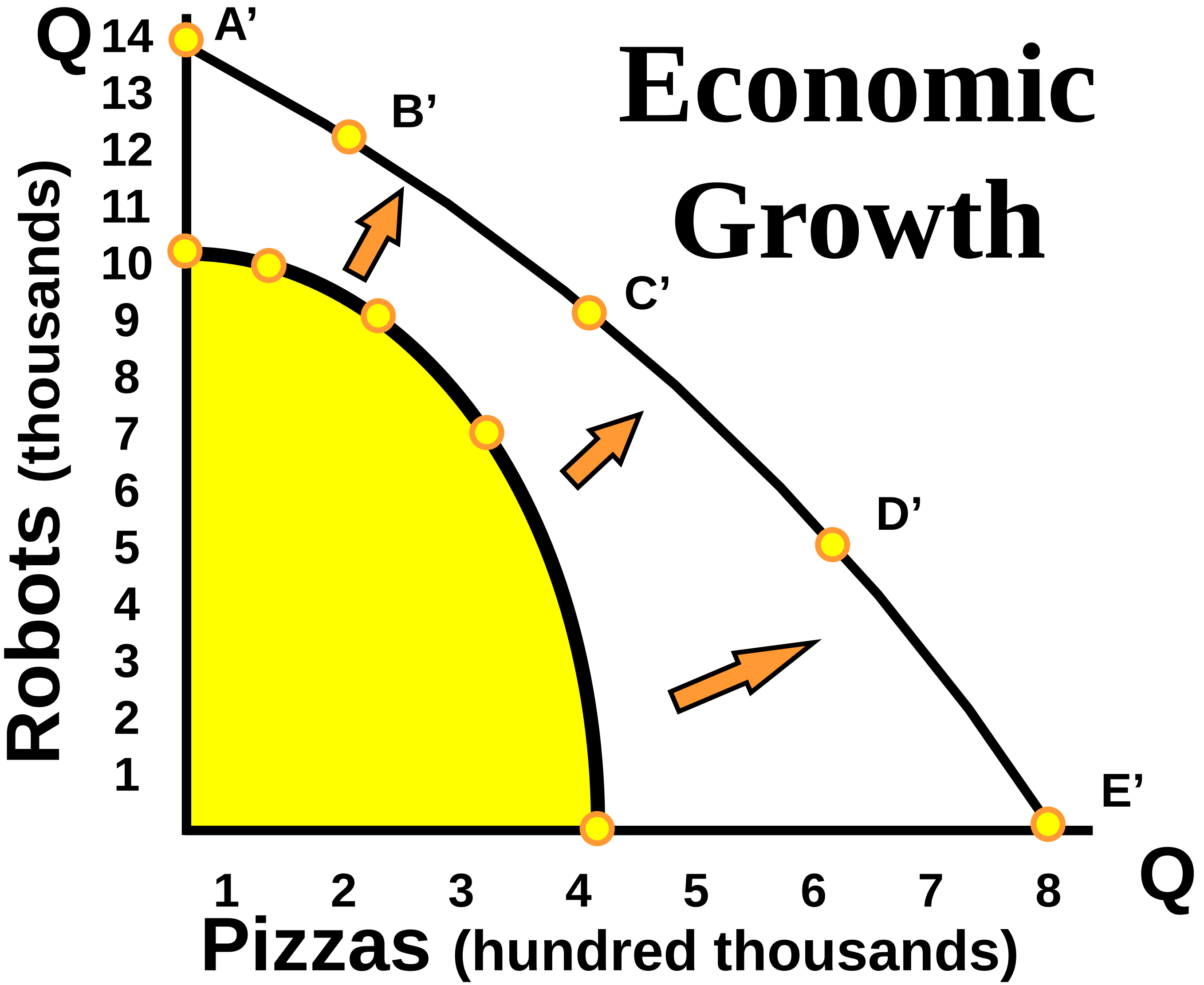
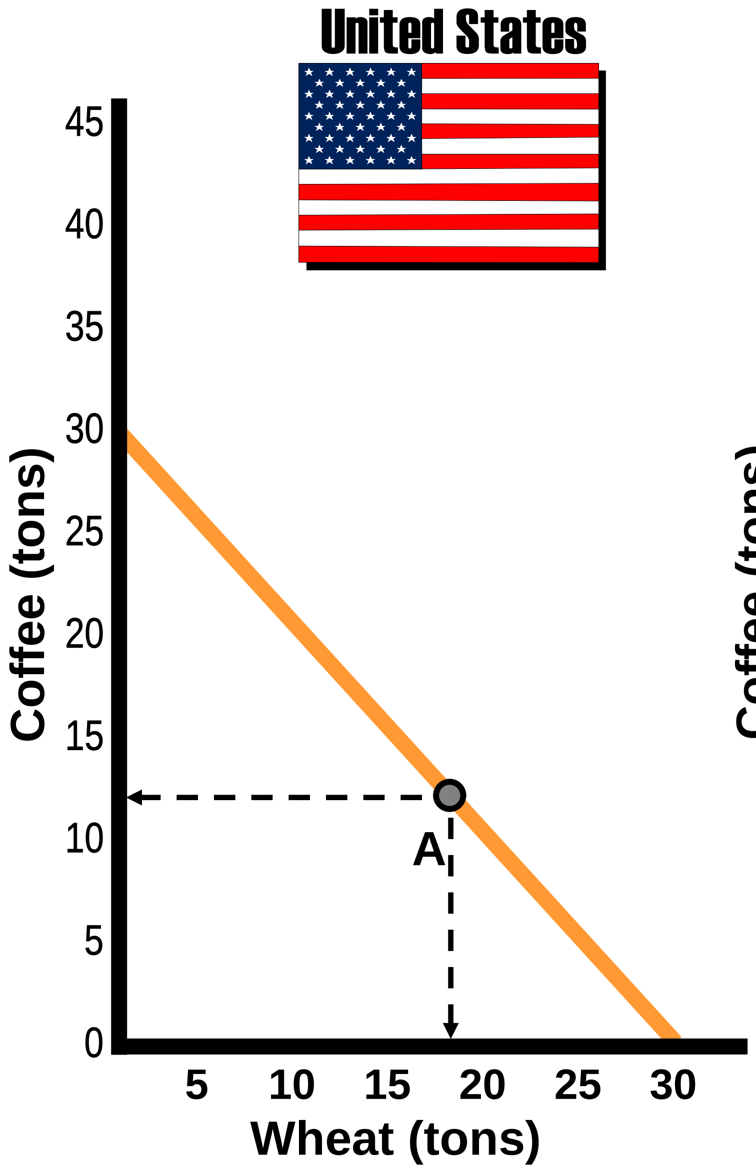
PRODUCTION POSSIBILITIES

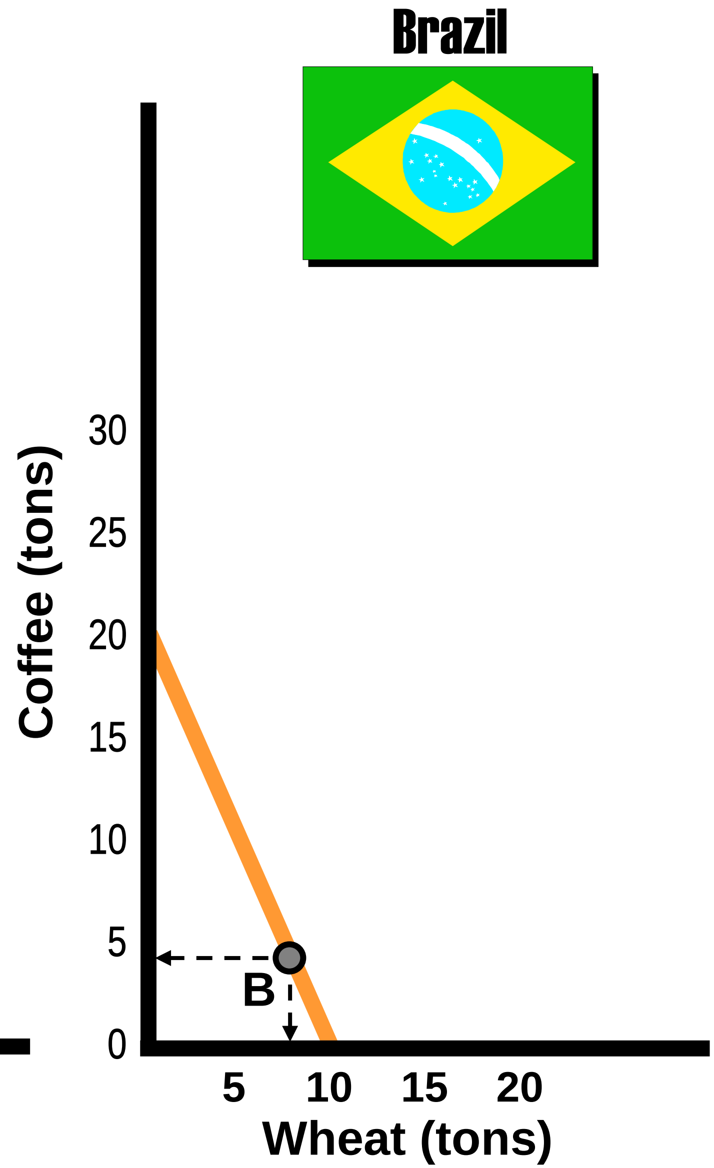


PRODUCTION POSSIBILITIES



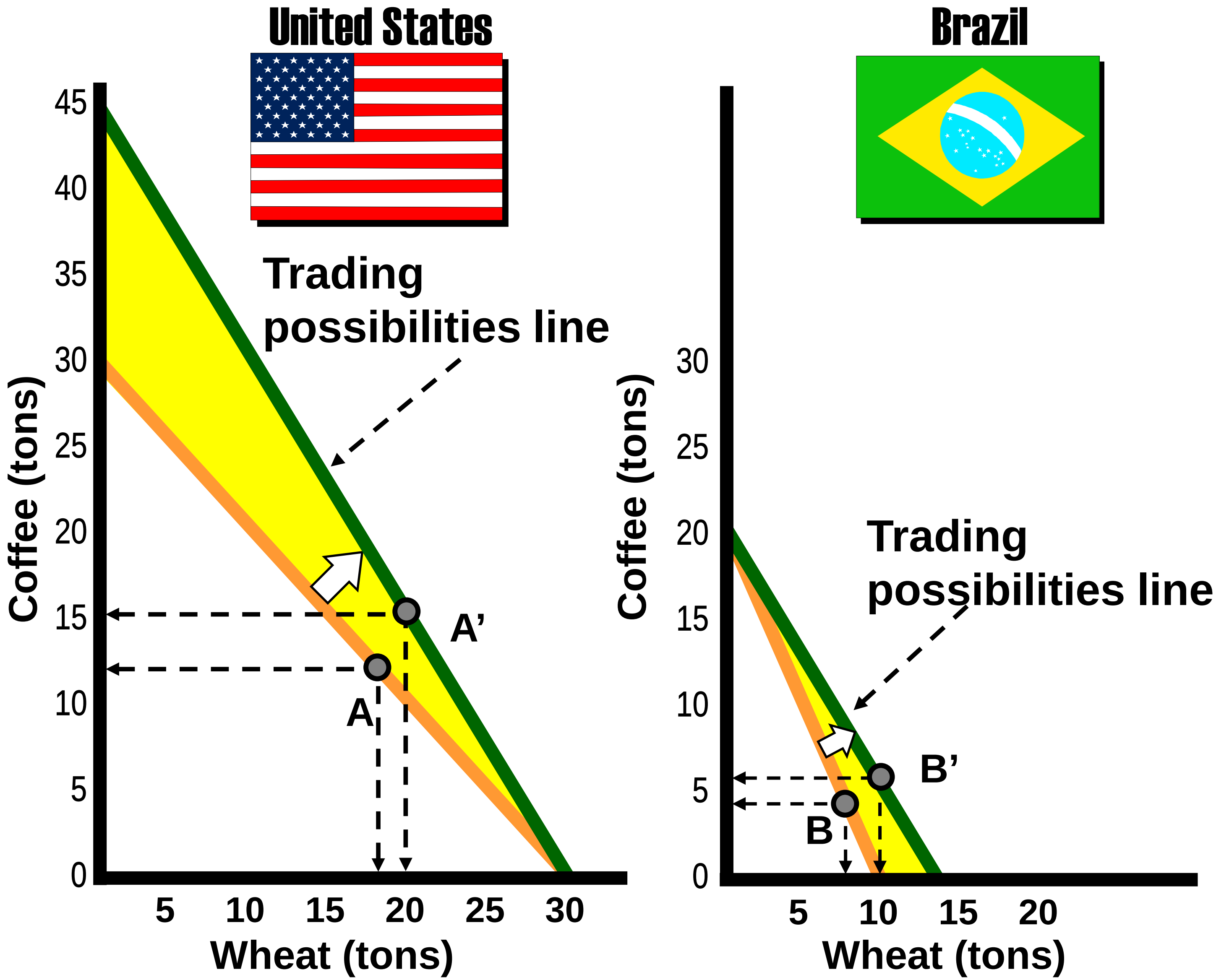
PRODUCTION POSSIBILITIES
Curve For Each Country



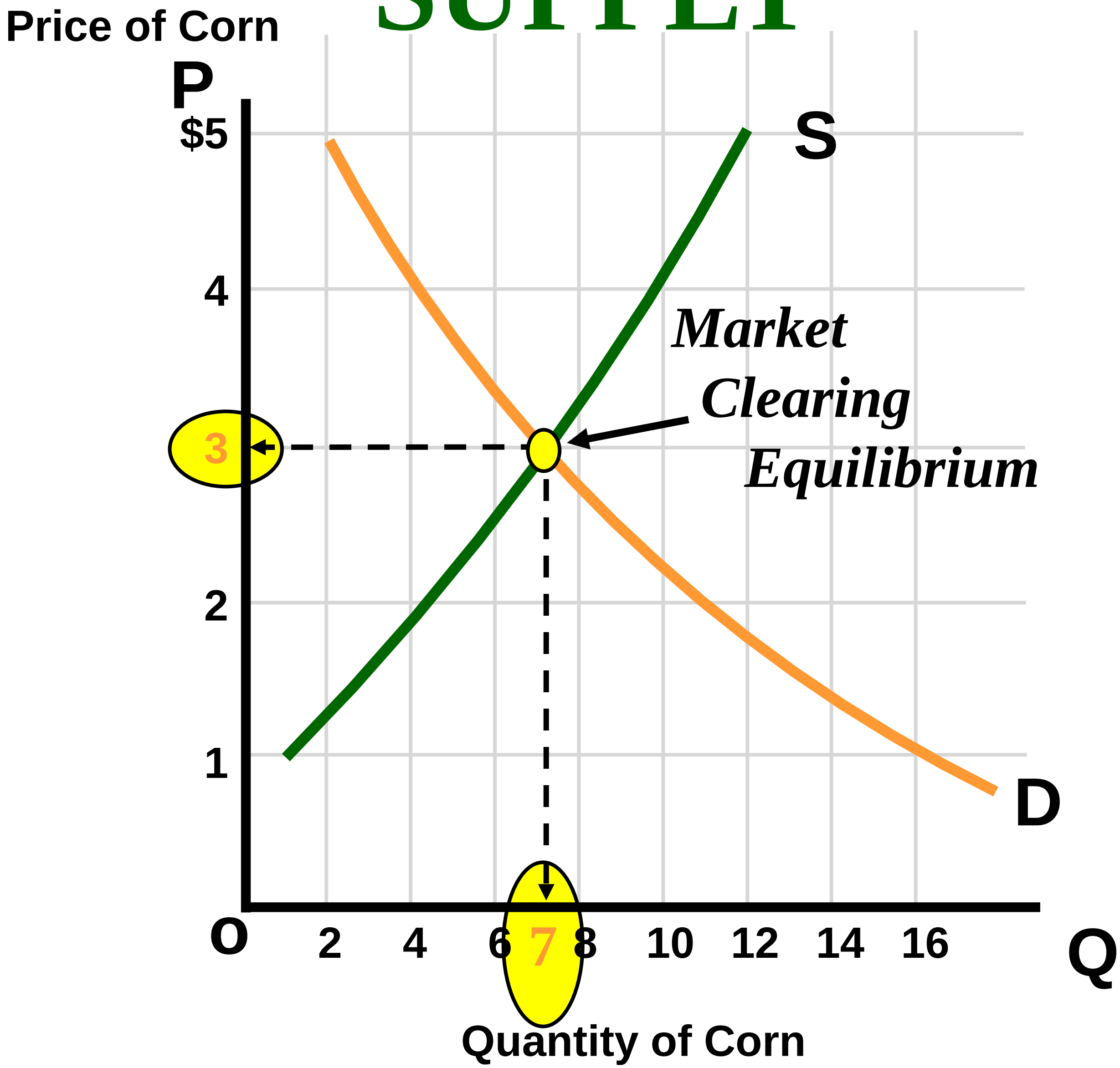


TRADING POSSIBILITIES LINES

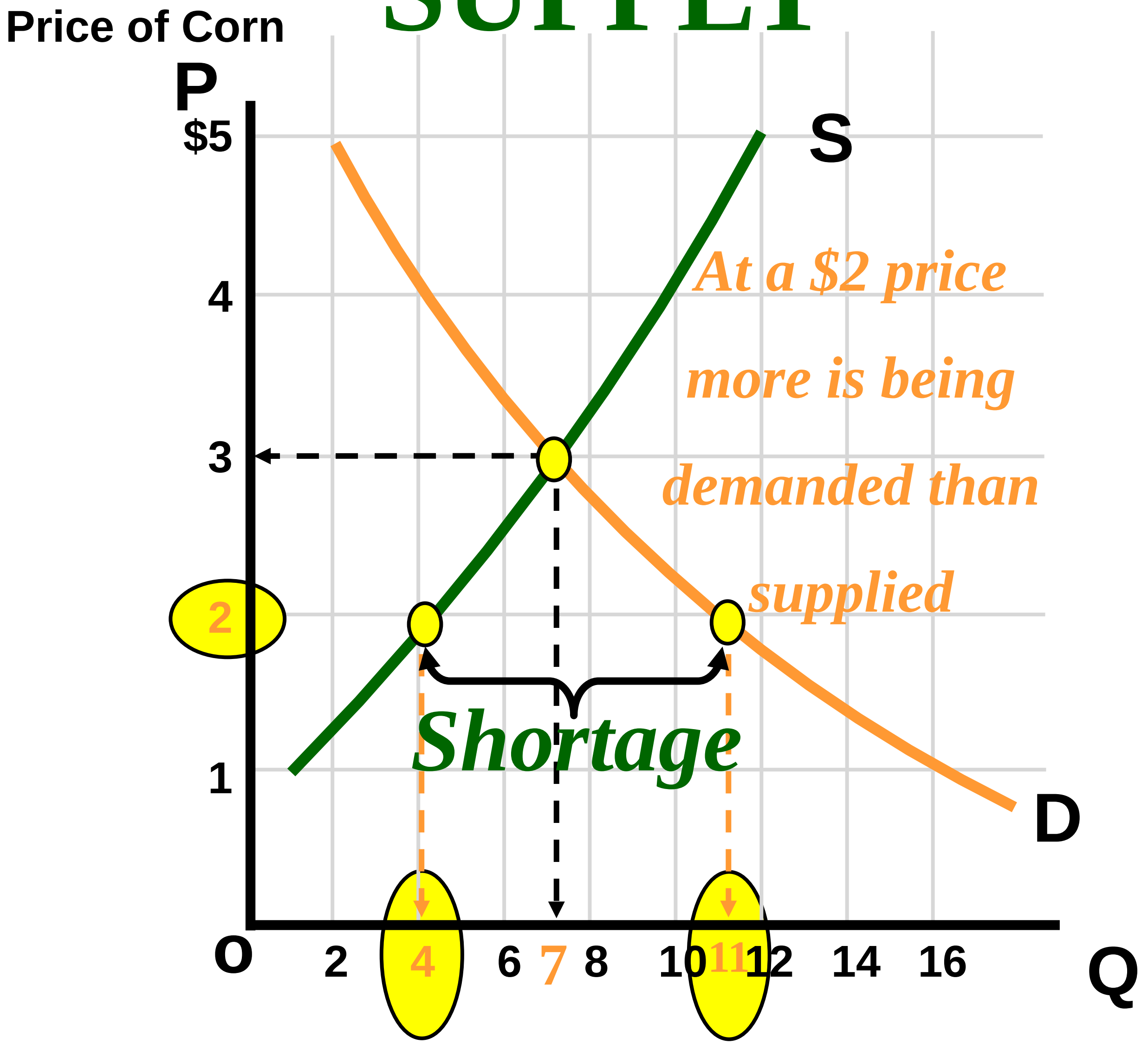
The Gains from Trade



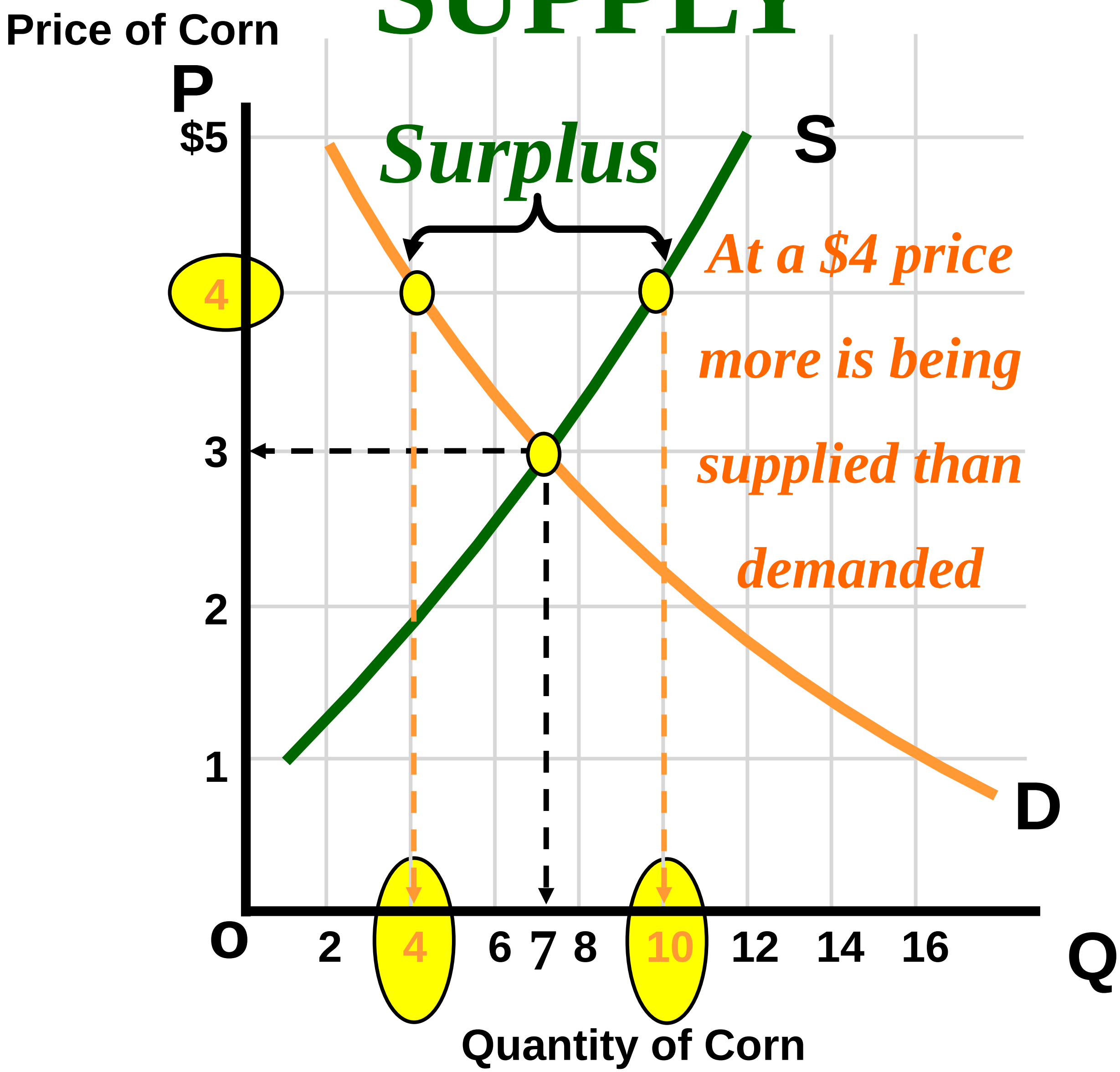
MARKET DEMAND & SUPPLY



MARKET DEMAND & SUPPLY



MARKET DEMAND & SUPPLY



THE MARKET FOR CURRENCY

Dollar appreciates / Pound depreciates

£1 : $1

£2 : $1

£ / $

2 / 1 = 2

Dollar depreciates / Pound appreciates

£1 : $1

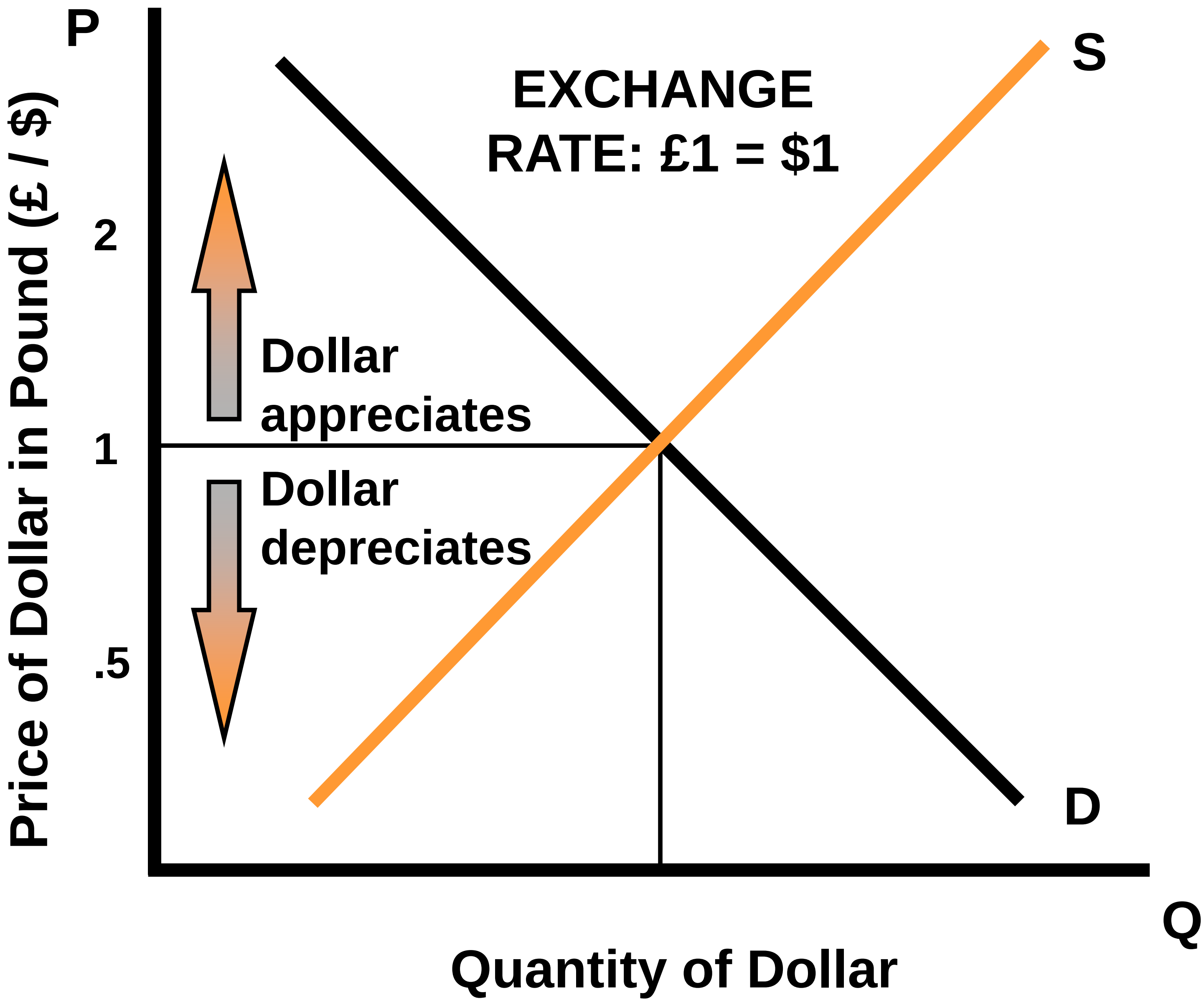
£1 : $2

£.5 : $1

£ / $

1 / 2 = .5

.5/ 1 = .5



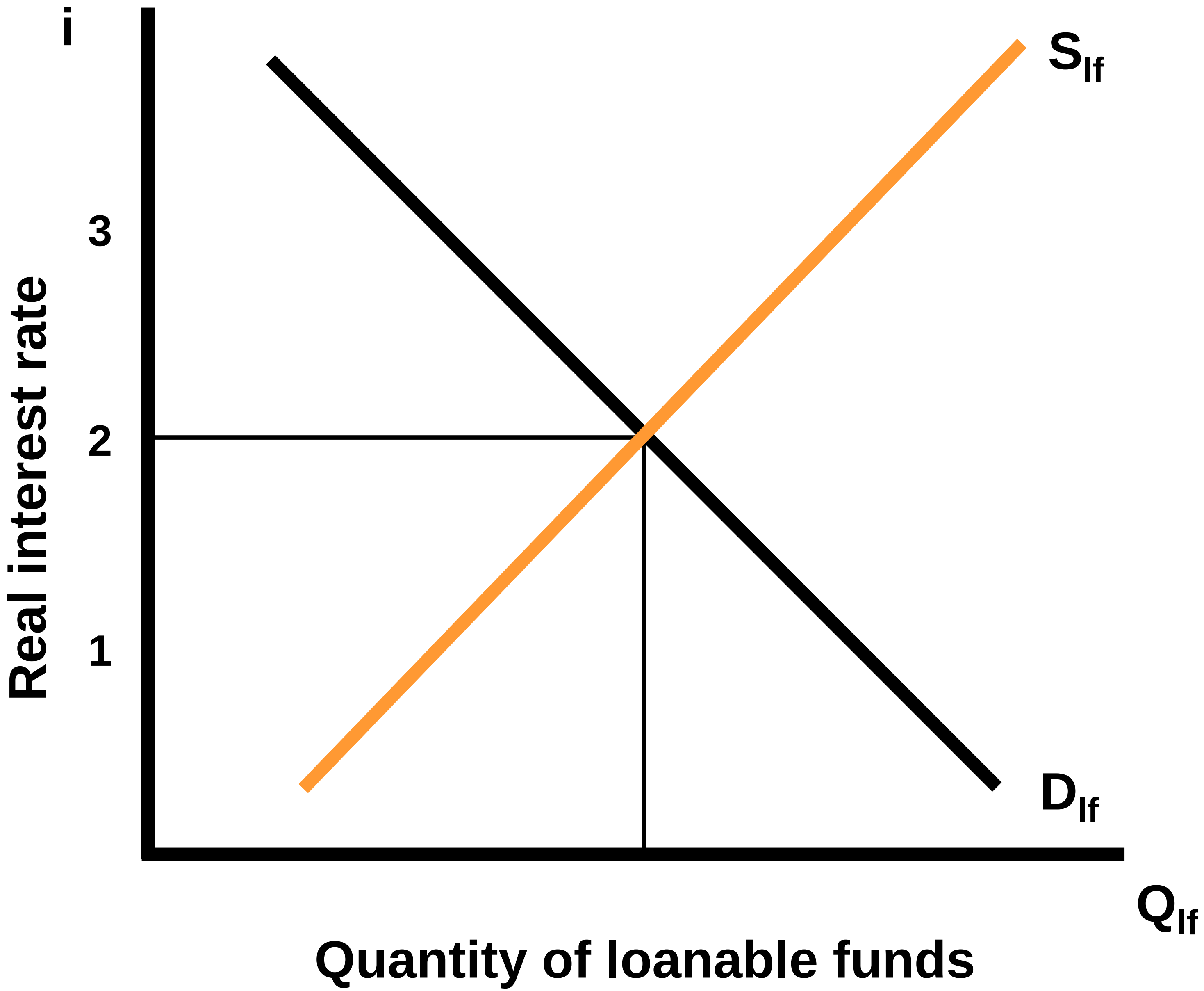
Loanable Funds Market

Demand for Loanable Funds

- Businesses
- Government

Supply of Loabable Funds

- Households



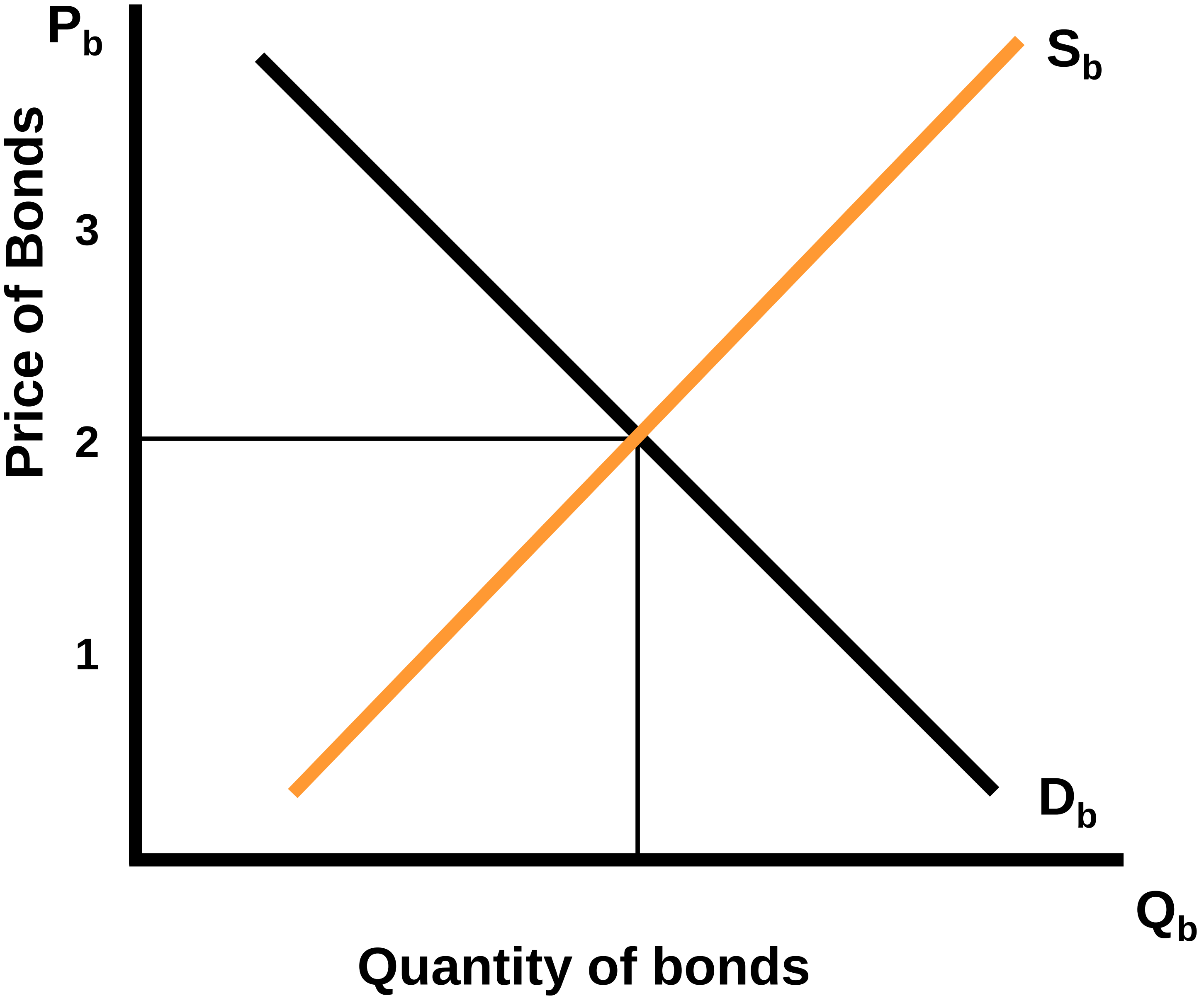
Bond Market

Demand for Bonds

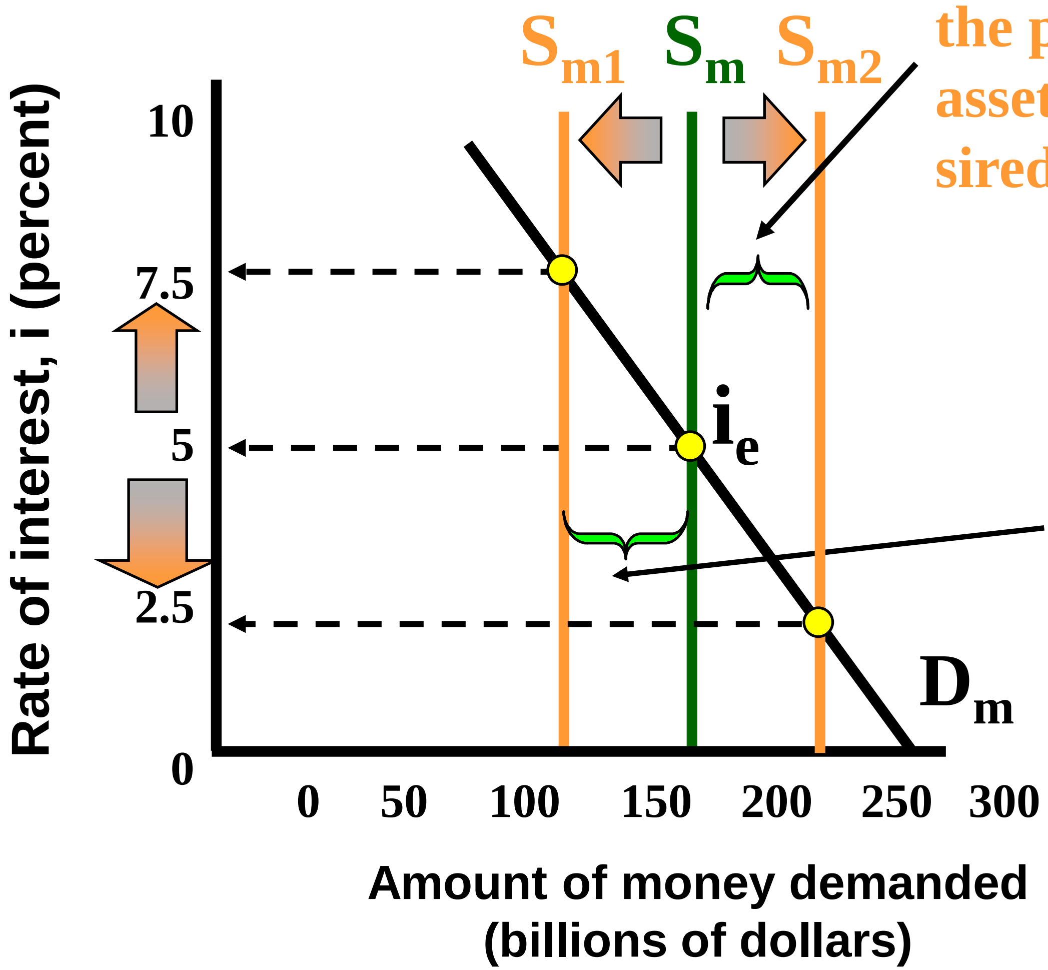
- Households

Supply of Bonds

- Businesses
- Government



THE MONEY MARKET



A temporary ***surplus*** of money will require the purchase of some assets to meet the desired level of liquidity.

A temporary ***shortage*** of money will require the sale of some assets to meet the need.

Average and Marginal Propensities

APC

Consumption / Disposable Income

APS

Saving / Disposable Income

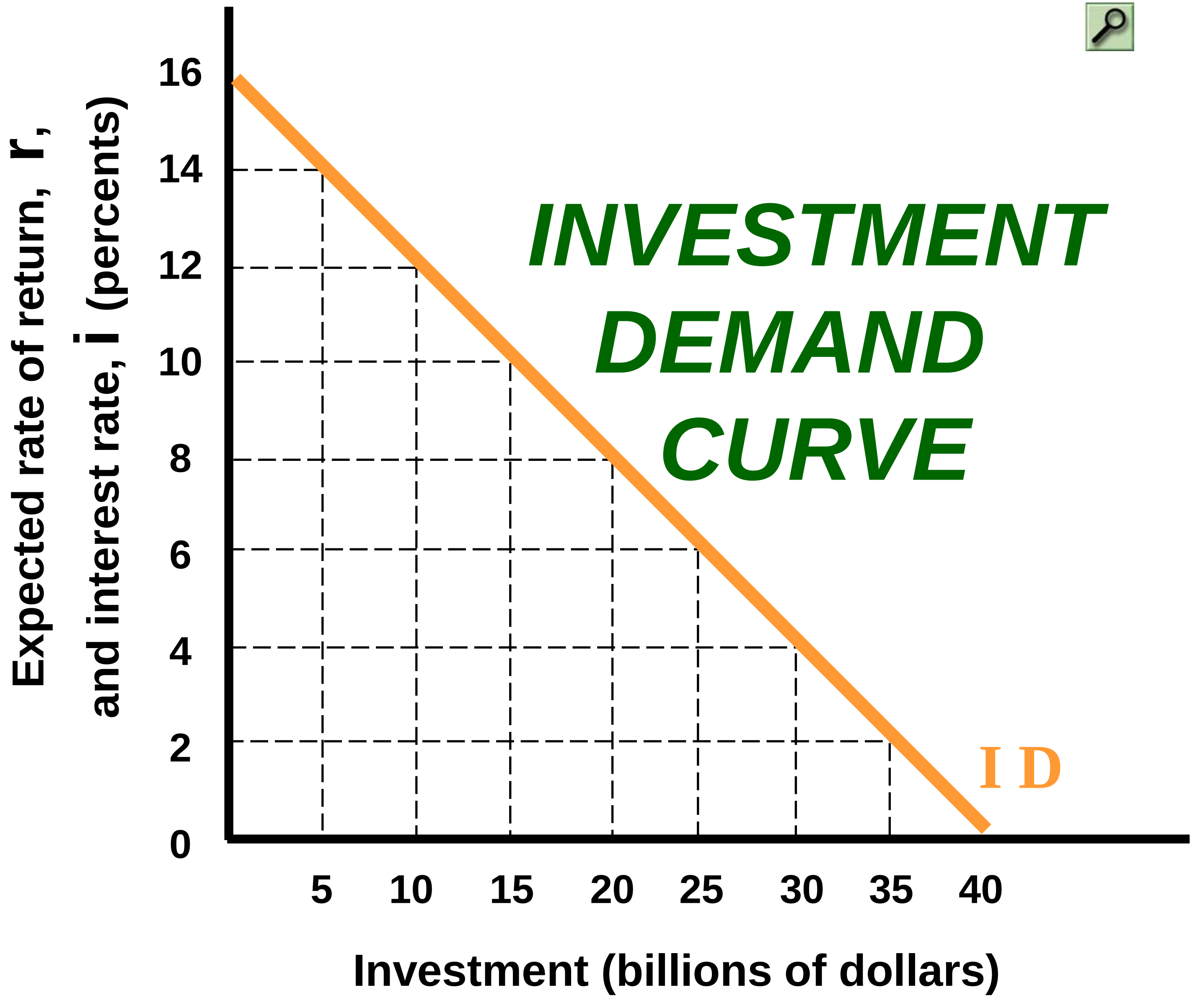
MPC

$$\frac{\textbf{Change in Consumption}}{\textbf{Change in Disposable Income}}$$

MPS

$$\frac{\textbf{Change in Saving}}{\textbf{Change in Disposable Income}}$$

INVESTMENT



INVESTMENT DEMAND CURVE
I D
Expected rate of return, r,
and interest rate, i (percents)
16
14
12
10
8
6
4
2
0
5
10
15
20
25
30
35
40
Investment (billions of dollars)

THE MULTIPLIER EFFECT

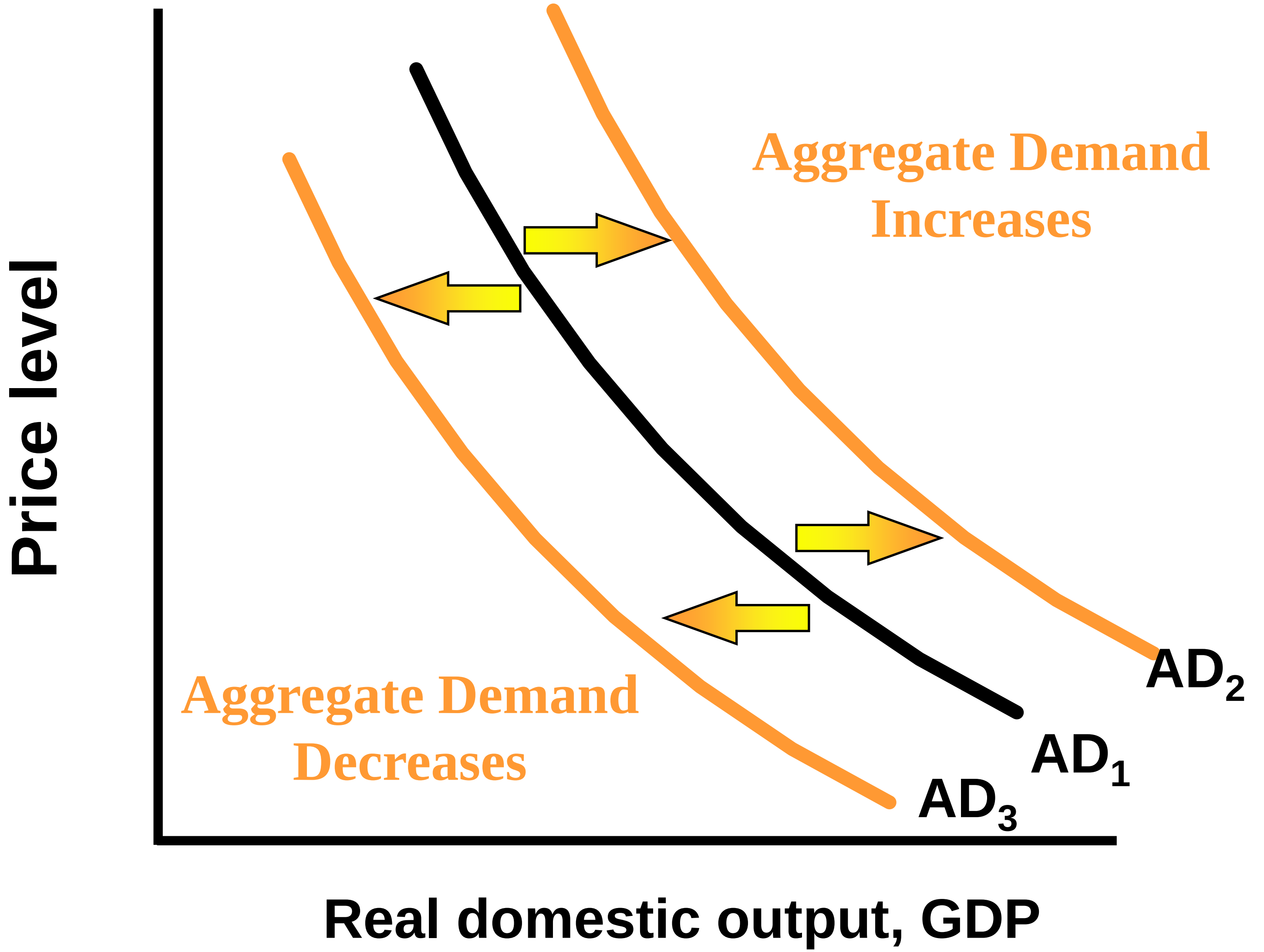
$$\text{Multiplier} = \frac{1}{\text{MPS}} \quad \textit{or} \quad \frac{1}{1 - \text{MPC}}$$

Inverse relationship between

Multiplier & MPS

$$\text{Change in GDP} = \text{Multiplier} \times \text{initial change in spending}$$

AGGREGATE DEMAND



DETERMINANTS OF AGGREGATE DEMAND

Change in Consumer Spending

- Consumer Wealth
- Consumer Expectations
- Consumer Indebtedness
- Taxes

Change in Investment Spending

- Real Interest Rates
- Expected Returns
  - Expected Future Business Conditions
  - Technology
  - Degree of Excess Capacity
  - Business Taxes

DETERMINANTS OF AGGREGATE DEMAND

<u>Government Spending</u>

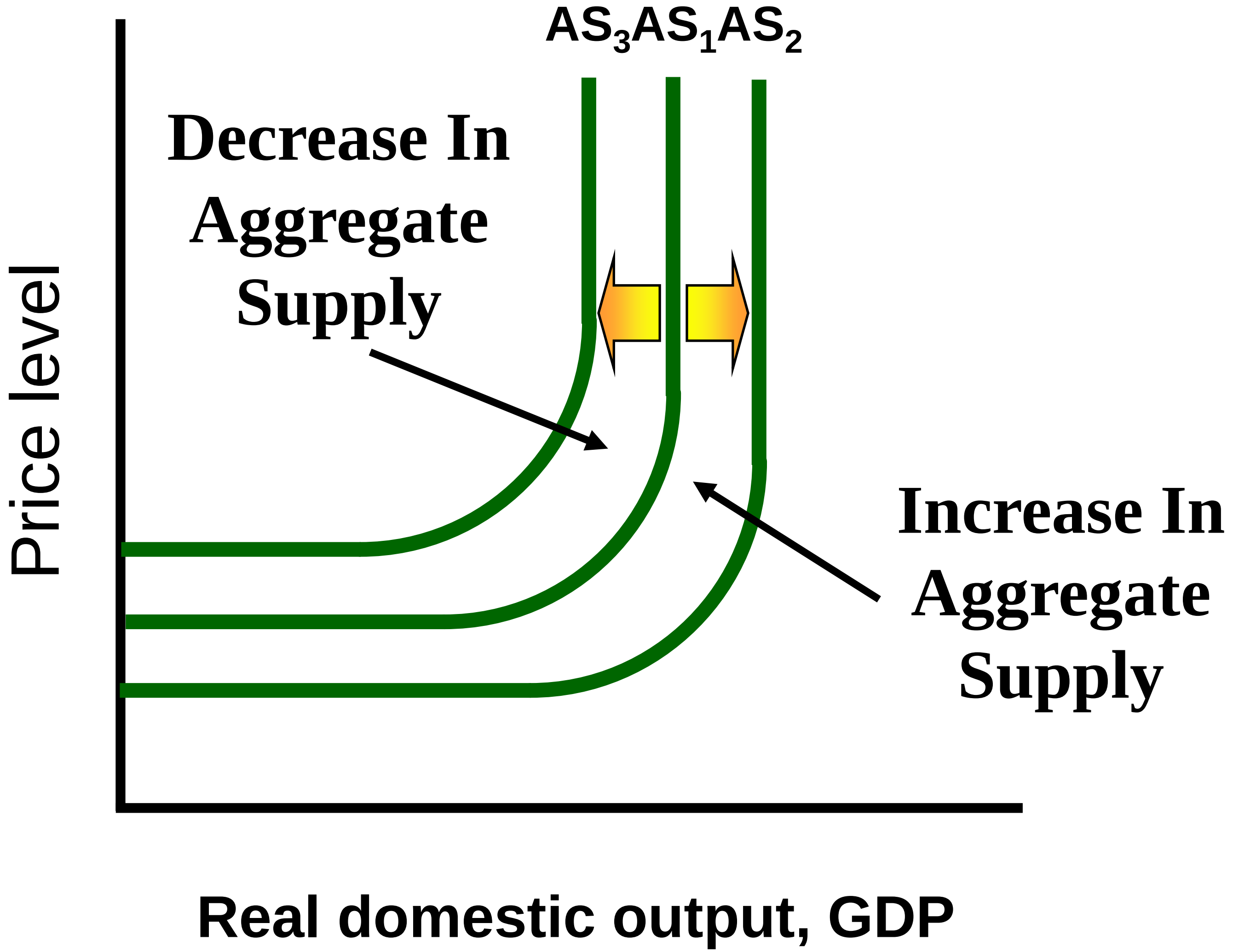
<u>Net Export Spending</u>

- **National Income Abroad**
- **Exchange Rates**

Changes in Aggregate Demand Shifts and the Aggregate Expenditures Model

Illustrated…

AGGREGATE SUPPLY



DETERMINANTS OF AGGREGATE SUPPLY

Change in Input Prices

Domestic Resource Availability

- Land
- Labor
- Capital
- Entrepreneurial Ability

Prices of Imported Goods

Market Power

DETERMINANTS OF AGGREGATE SUPPLY

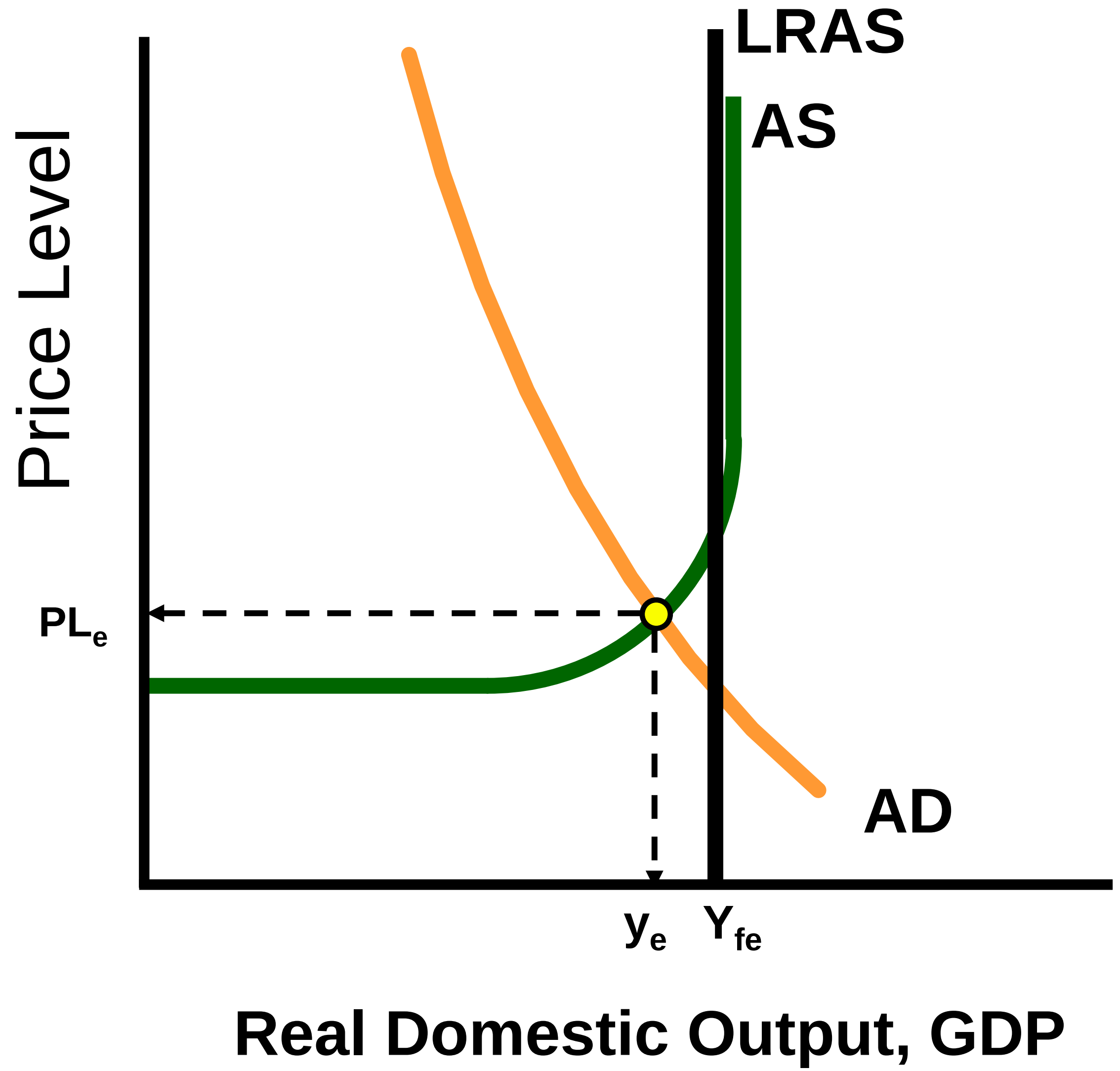
Change in Productivity

$$\text{Productivity} = \frac{\text{Real Output}}{\text{Input}}$$

Change in Legal-Institutional Environment

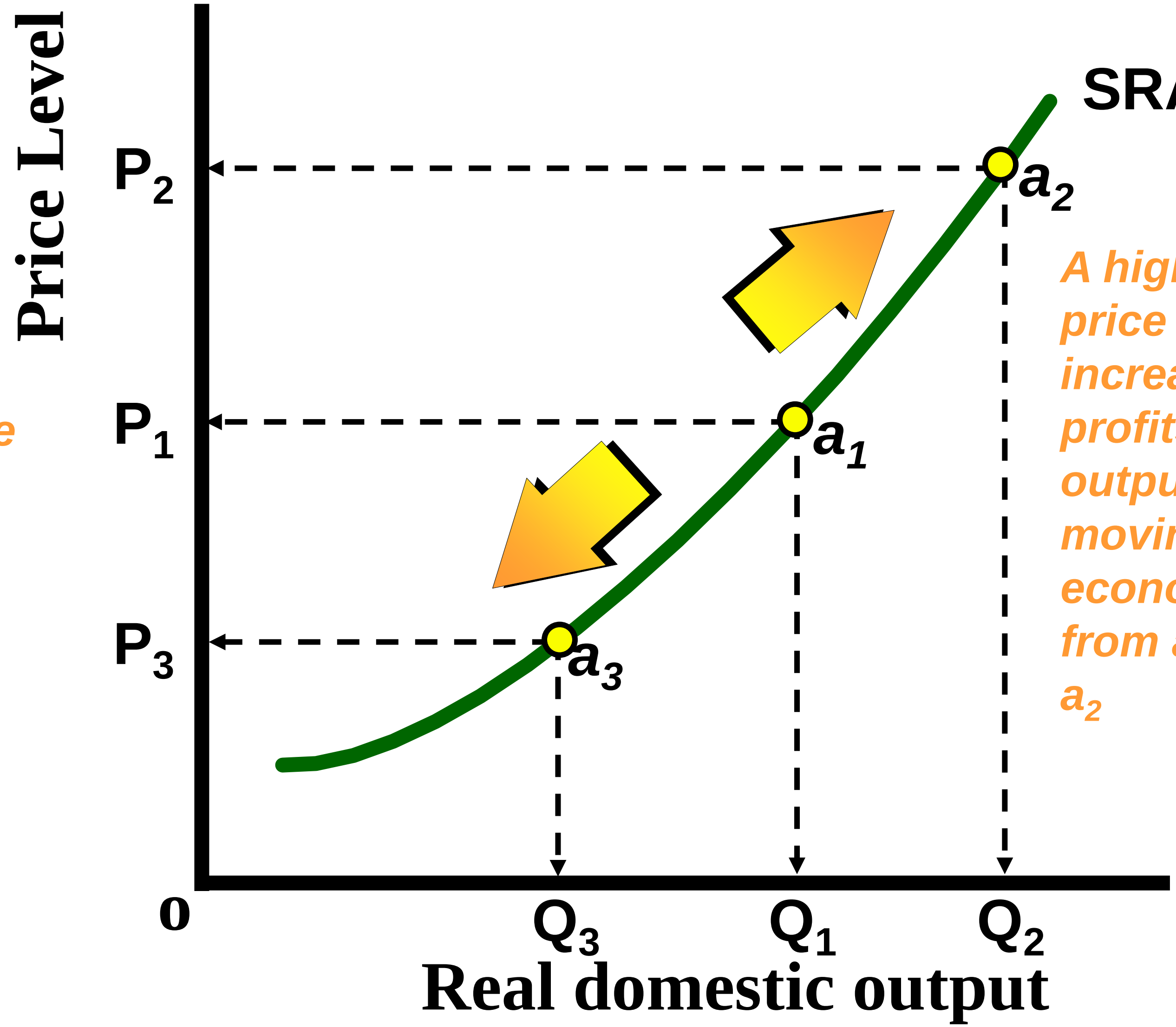
- Business Taxes and Subsidies
- Government Regulation

Equilibrium output short of full employment



SHORT-RUN AGGREGATE SUPPLY

A lower price level decreases profits and output moving the economy from a_1 to a_3



A higher price level increases profits and output moving the economy from a_1 to a_2

LONG RUN AGGREGATE SUPPLY

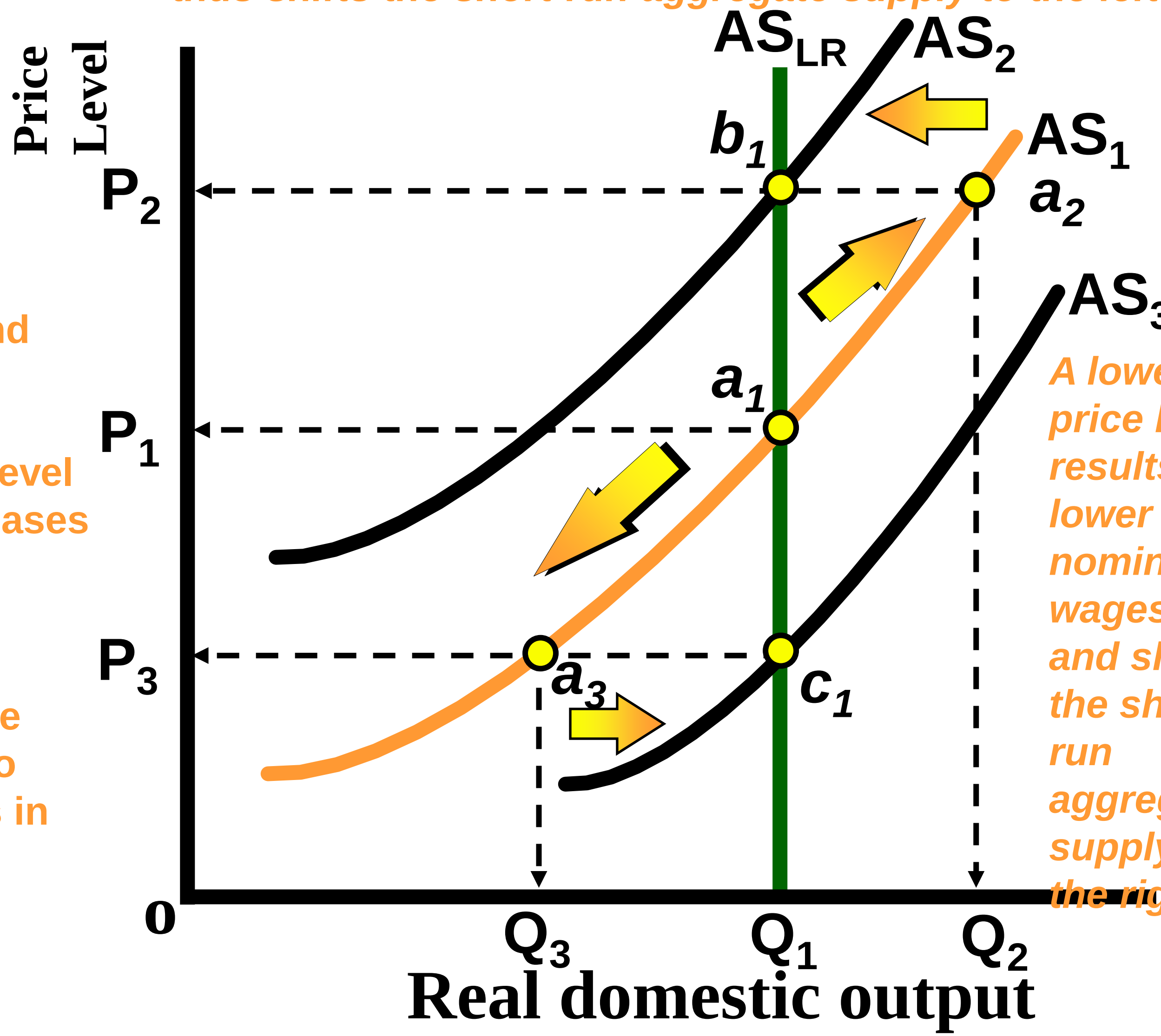
A higher price level results in higher nominal wages and thus shifts the short-run aggregate supply to the left

Short Run -

Period in which nominal wages (and other input prices) remain fixed as the price level increases or decreases

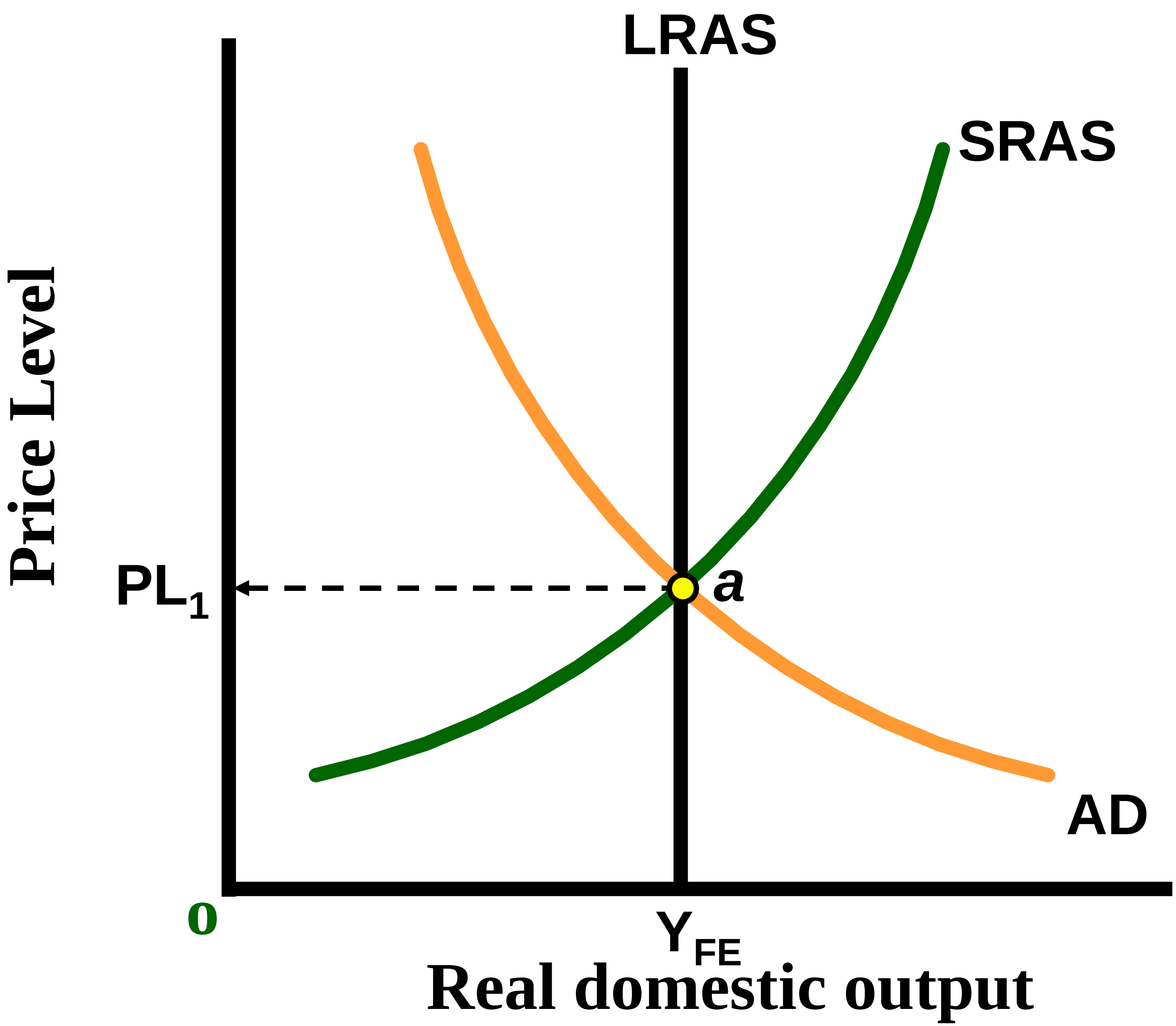
Long Run -

Period in which nominal wages are fully responsive to previous changes in the price level



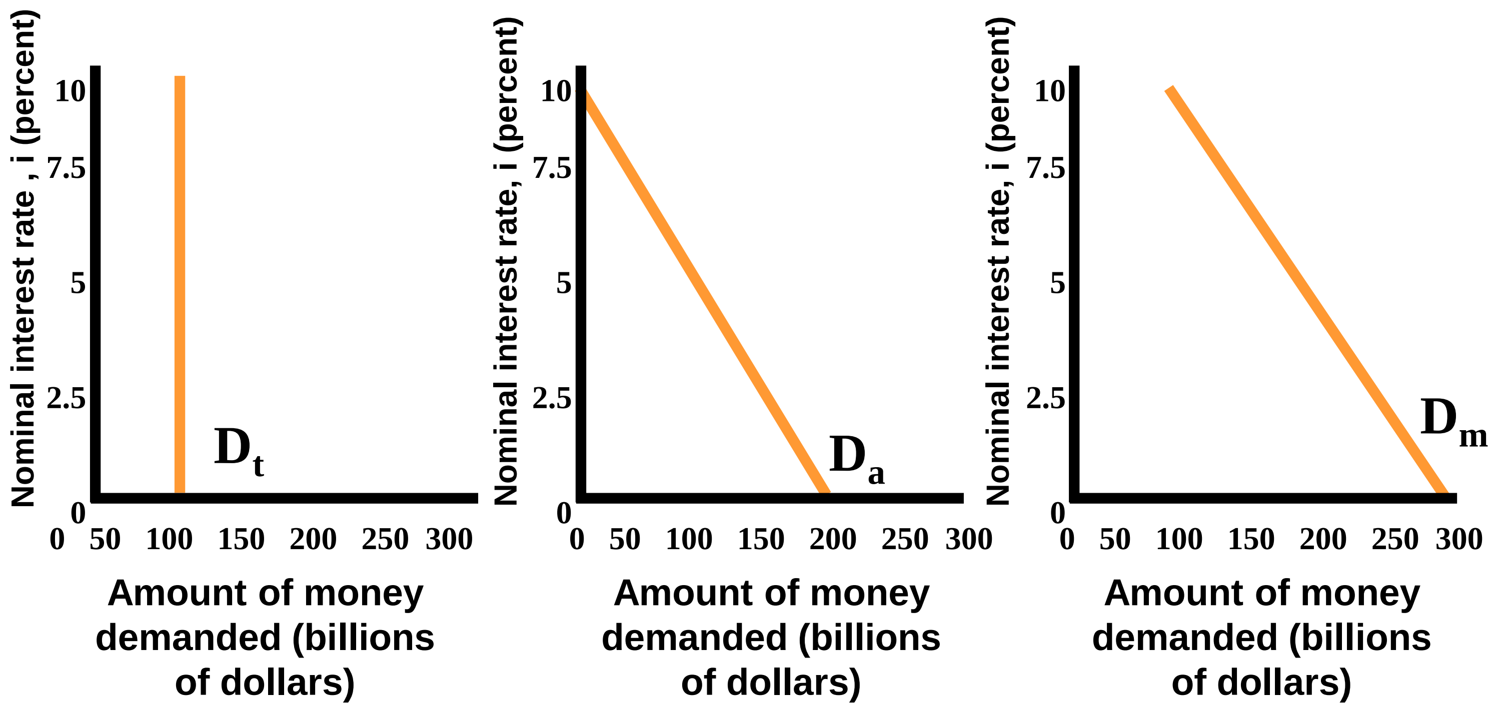
A lower price level results in lower nominal wages and shifts the short-run aggregate supply to the right

Equilibrium output at full employment

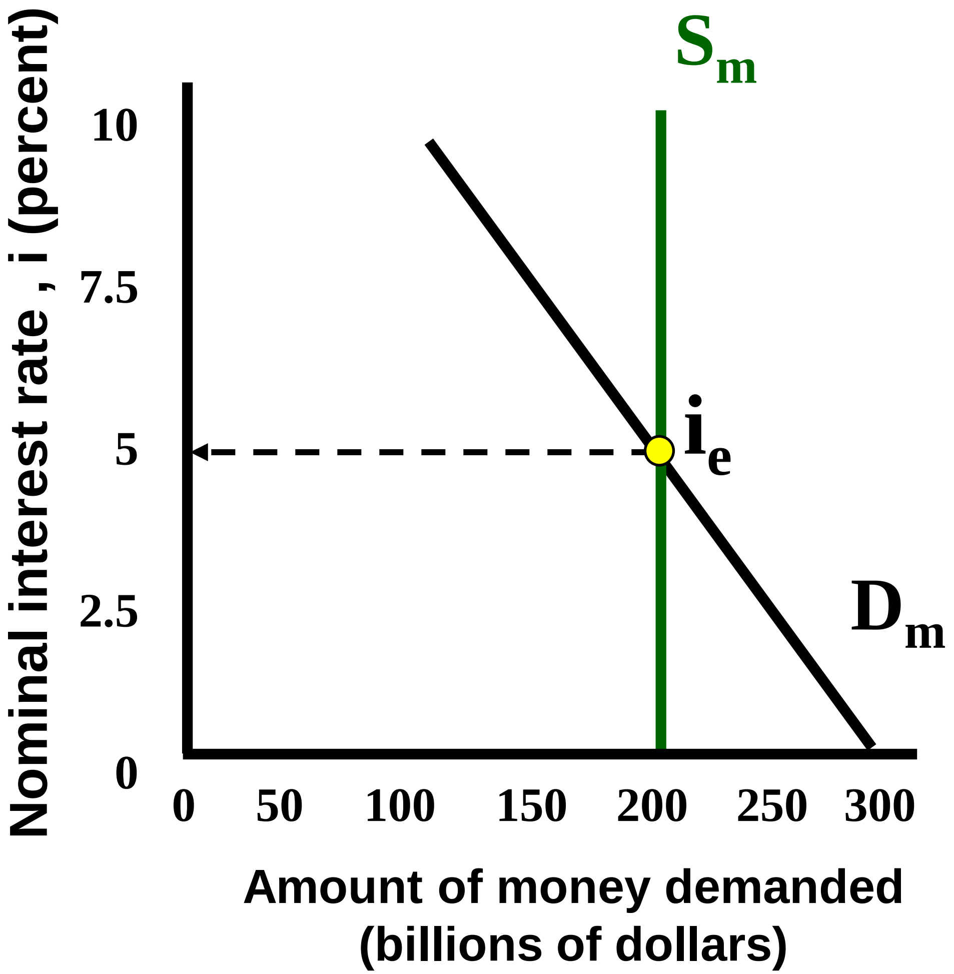


THE DEMAND FOR MONEY

Transactions Demand, D_t + Asset Demand, D_a = Total demand for money, D_m



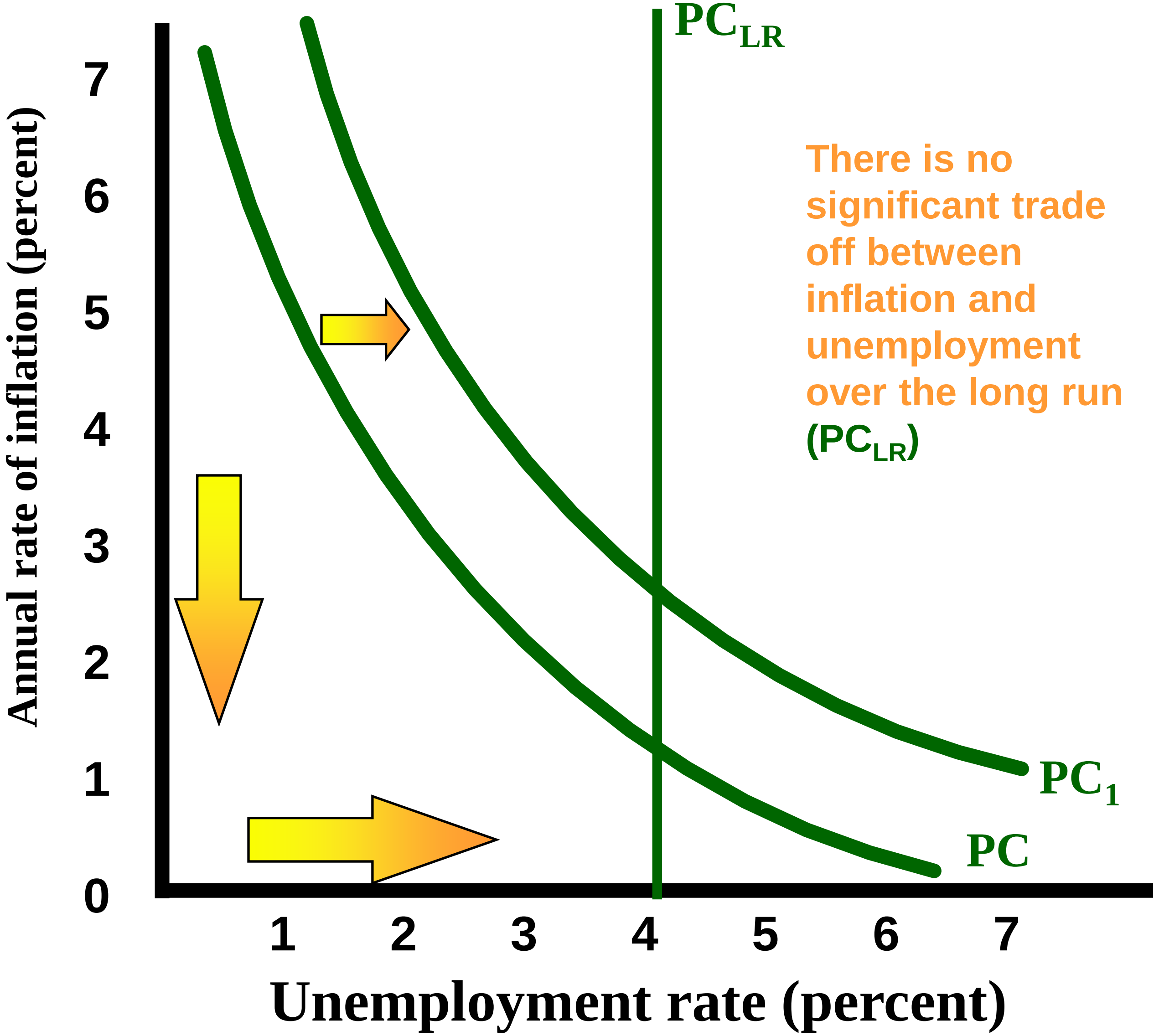
THE MONEY MARKET



THE PHILLIPS CURVE

Normally, there is a trade off between the rate of inflation and the rate of unemployment **(PC)**

Aggregate supply shocks can cause both higher rates of inflation and higher rates of unemployment **(shift from PC to PC1)**



There is no significant trade off between inflation and unemployment over the long run **(PC$_{LR}$)**

THE LAFFER CURVE