Aggregate Demand Outline/Summary

I. What is AD curve itself?
   A. What is equilibrium real output (Y*) at any given price level, such as P_o?
   B. Graphical derivation of Y*, where AE(Y) curve crosses 45° line
      1. What is AE(Y) curve?
      2. What are slope and intercept of AE(Y) curve?
      3. What changes shift AE(Y) curve up or down?
      4. What causes movement along AE(Y) curve? (Change in firms’ production, Y, right?)
      5. Using AE(Y) curve, what happens when actual Y > Y* (i.e., unintentional inventory investment > 0, causes firms to cut production.) What about when actual Y < Y*?
   C. Algebraic derivation of formula for Y* (taking T, I_p, IM as exogenous, i.e., not depending on Y)

II. What causes shift in AD curve? (i.e., what causes change in Y* at any given P? You should be able to answer using either the graphical or the algebraic derivation of Y* from Section I above.)
   A. Demand shocks – changes to exports (EX), business confidence (I_p), consumer confidence (a)
   B. Fiscal policy – changes in G and/or T
   C. Monetary policy
      1. Changes in M* -> change in r_{eq} -> change in I_p and C -> shifts AE(Y) curve -> changes Y*
      2. What is M1? How is it controlled by Fed by buying/selling bonds?
      3. What is M^d? How and why does it depend on r and on PY?
      4. How is r_{eq} determined in money “market”? How is it affected by Fed’s purchases or sales of bonds?
   D. How much does AD curve shift? (Multiplier effect)
      1. algebraic derivation (taking T, I_p, IM as exogenous, i.e., not depending on Y)
         a. -> multiplier (ΔY/ΔG) = (ΔY/ΔI_p) = (ΔY/ΔEX) = 1/ {1 - MPC} = 1/ {1 - b}
         b. -> tax multiplier (ΔY/ΔT) = - b/(1 - b)
            (opposite sign, smaller in magnitude by factor of MPC)
      2. sense for
         a. why multiplier > 1
         b. why fact that T depends directly on Y
            i. -> real world multiplier smaller than simple model indicates
               (So-called “automatic stabilizer” function of income taxes)
               ii. i.e., approximately 2 rather than 1/(1-MPC) = 5.

III. What causes movement along AD curve? Why is AD curve downward sloping?
   A. How does change in P cause change in Y*?
   B. Simple version: change in P -> change in real wealth -> shifts consumption function up or down
   C. Later, better, version: Change in P -> change in PY -> shifts M^d curve -> changes r_{eq}
      -> changes I_p and also shifts consumption function up or down.