

Unit 3: National Income & Price Determination Cheatsheet

Aggregate Demand (AD)

- Definition: Total demand for goods and services in the economy at different price levels.

Factors that Shift AD:

- Consumer Confidence
 - Interest Rates
- Fiscal Policy (Government Spending & Taxes)
- Exchange Rates (affects exports/imports)

Components of AD:

- Consumption (C)
- Investment (I)
- Government Spending (G)
- Net Exports (X - M)

Aggregate Supply (AS)

Definition: Total supply of goods and services in an economy at different price levels.

Short-Run AS (SRAS):

- Upward sloping: Higher prices lead to higher output.

Long-Run AS (LRAS):

- Vertical at potential output: Reflects full employment and maximum sustainable output.

Factors that Shift SRAS:

- Changes in input prices (wages, raw materials).
- Supply shocks (e.g., natural disasters).
- Changes in productivity.

Factors that Shift LRAS:

- Changes in resources (capital, labor, technology).
- Economic growth.

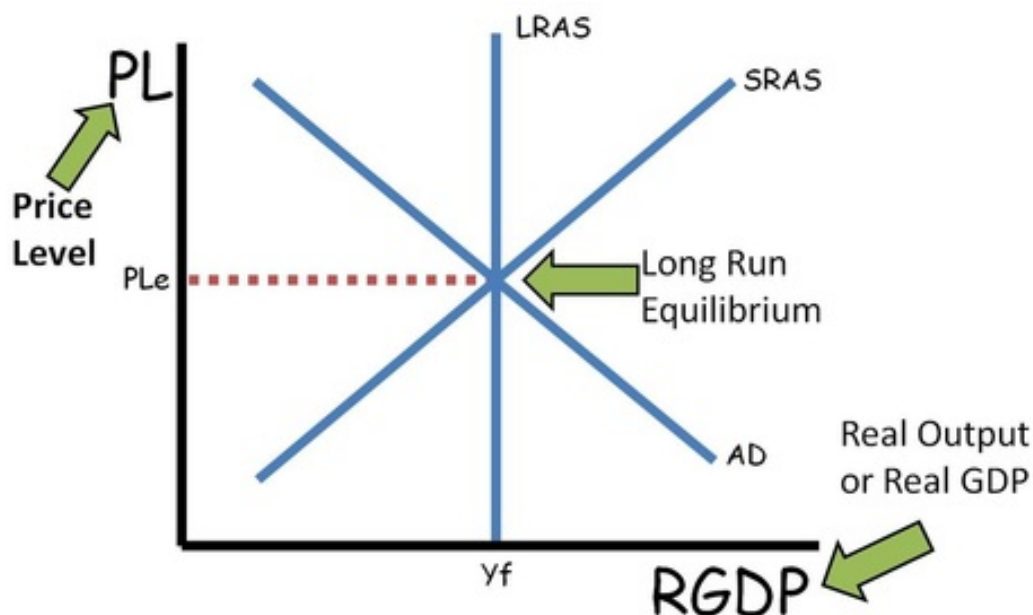


image from ReviewEcon

Short-Run Equilibrium

AD = SRAS.

- Determines current output and price level.

Long-Run Equilibrium

AD = LRAS = SRAS.

- Economy at full employment (no cyclical unemployment).

The Spending Multiplier

- Definition: Shows how an initial change in spending leads to a larger change in GDP.

$$\text{Multiplier} = \frac{1}{1 - MPC}$$

$$MPC + MPS = 1$$

- MPC: Marginal Propensity to Consume.
- MPS: Marginal Propensity to Save.

Fiscal Policy

Definition: Government use of taxes/spending to influence the economy.

Types:

- Expansionary: Increase spending/decrease taxes → AD ↑.
- Contractionary: Decrease spending/increase taxes → AD ↓.

Tools of Fiscal Policy:

1. Discretionary: New government policies (e.g., stimulus package).
2. Automatic Stabilizers: Built-in policies (e.g., unemployment benefits, progressive taxes).