
Aggregate Supply & Demand

Lecture 9

The IS-LM Model \Rightarrow AD Curve

- ◆ $C = C (G, T, i, GDPW)$
- ◆ $I = I (G, T, i, GDPW)$
- ◆ $M = M (G, T, i, GDPW)$
- ◆ $X = X (G, T, i, GDPW)$
- ◆ IS Curve: $GDP = C + I + X - M + G$
 - ◆ $= GDP (G, T, i, GDPW)$
- ◆ (Simplified Money Demand) $Md/P = GDP * L (i)$
- ◆ Money Supply = M_s
- ◆ Equilibrium: $Md = M_s \Rightarrow M_s = P * GDP * L (i)$, or solving for $i \Rightarrow$
- ◆ LM Curve: $i = i (M_s / (P * GDP))$
- ◆ Aggregate Demand AD: insert LM curve into the IS Curve:
- ◆ $GDP = GDP (G, T, GDPW, P, M_s)$

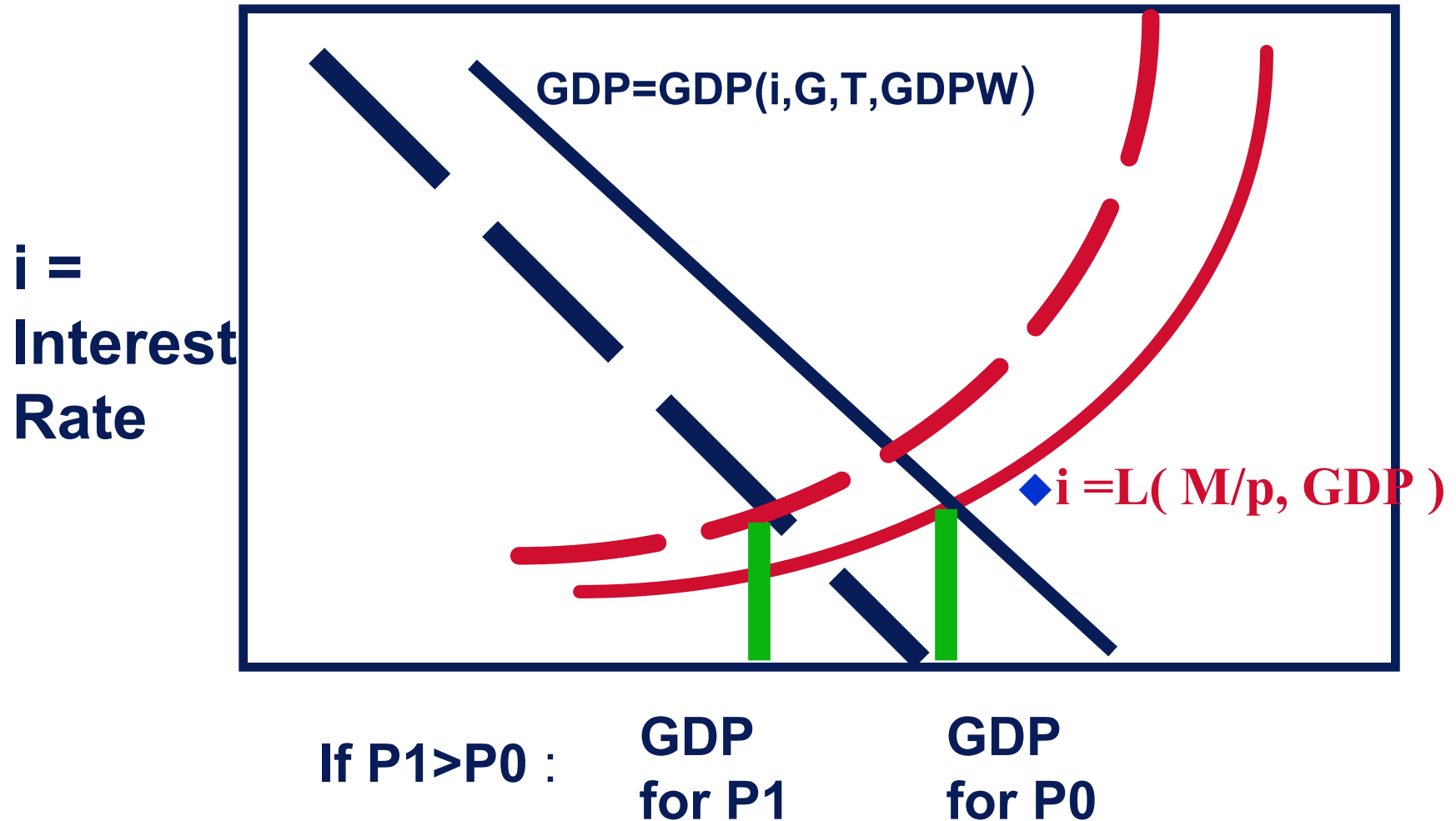
Aggregate Demand

- ◆ “Demand” curves in economics traditionally refer to relationships between the quantity demanded and the price of the good or service
- ◆ In macroeconomics, *the aggregate demand curve...is nothing more than the intersections of the IS-LM curves for different price levels. Or, it traces the reduced form equation for GDP at different price levels. Therefore, the AD curve shows the equilibrium output associated with each price.*

Aggregate Demand

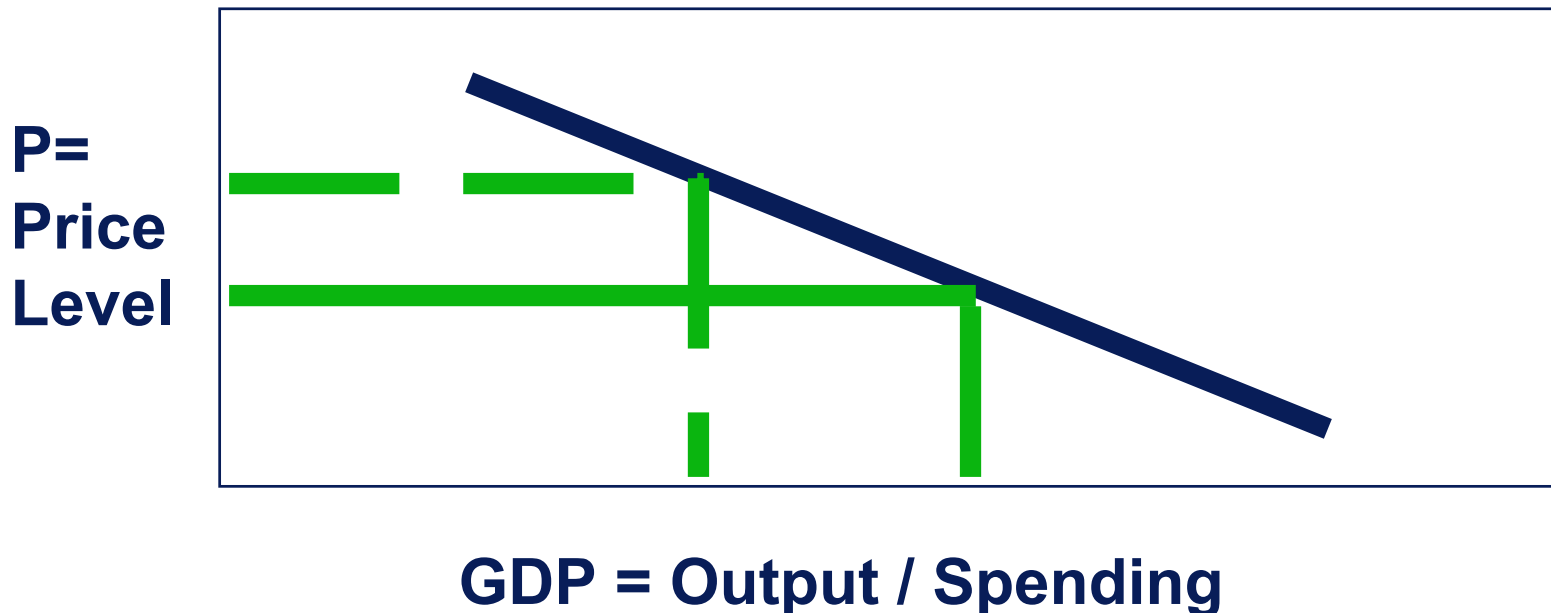
- ◆ The aggregate demand curve is the intersection of the IS-LM curves for different price levels. It shows the equilibrium output associated with each price.
- ◆ *How do price changes affect IS:goods market?*
- ◆ *How do price changes affect LM:money market?*
- ◆ *Can you conclude then how they will affect the equilibrium points?*

“IS - LM”: Reactions to Higher Prices



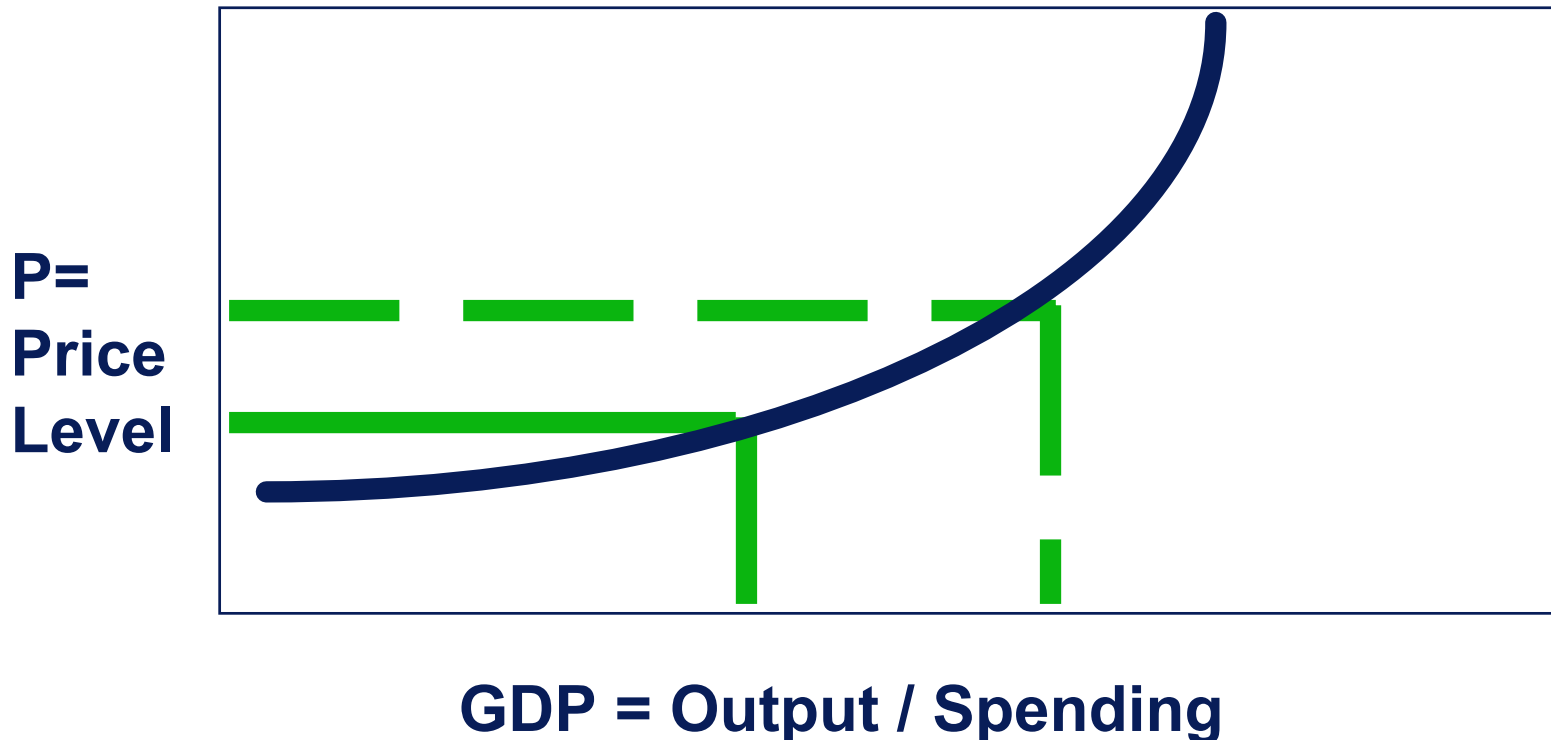
Aggregate Demand

- ◆ The aggregate demand curve is the intersection of the IS-LM curves for different price levels. It shows the equilibrium output associated with each price.



Aggregate Supply

- ◆ The aggregate supply curve is the level of domestic output that producers will supply given a price level for their output.



Aggregate Supply

- ◆ aggregate supply: domestic output given a price level for domestic output. How will it shift if the international price of oil rises and the domestic output price (P) doesn't?

