Econ 2 - Lecture 17 - 6/2/25

Lecture Quiz #9 Released Wednesday, June 4th
↳ Due Before Final Exam, Tuesday, June 10th at 12pm

Discussion Activity #5 ⇒ AI-guided studying

Final Exam → 40 Multiple Choice Questions
↳ June 10th from 12:00 – 2:30pm

Practice Final Exam Key Posted Later this Week

For those wanting more practice problems... create your own!

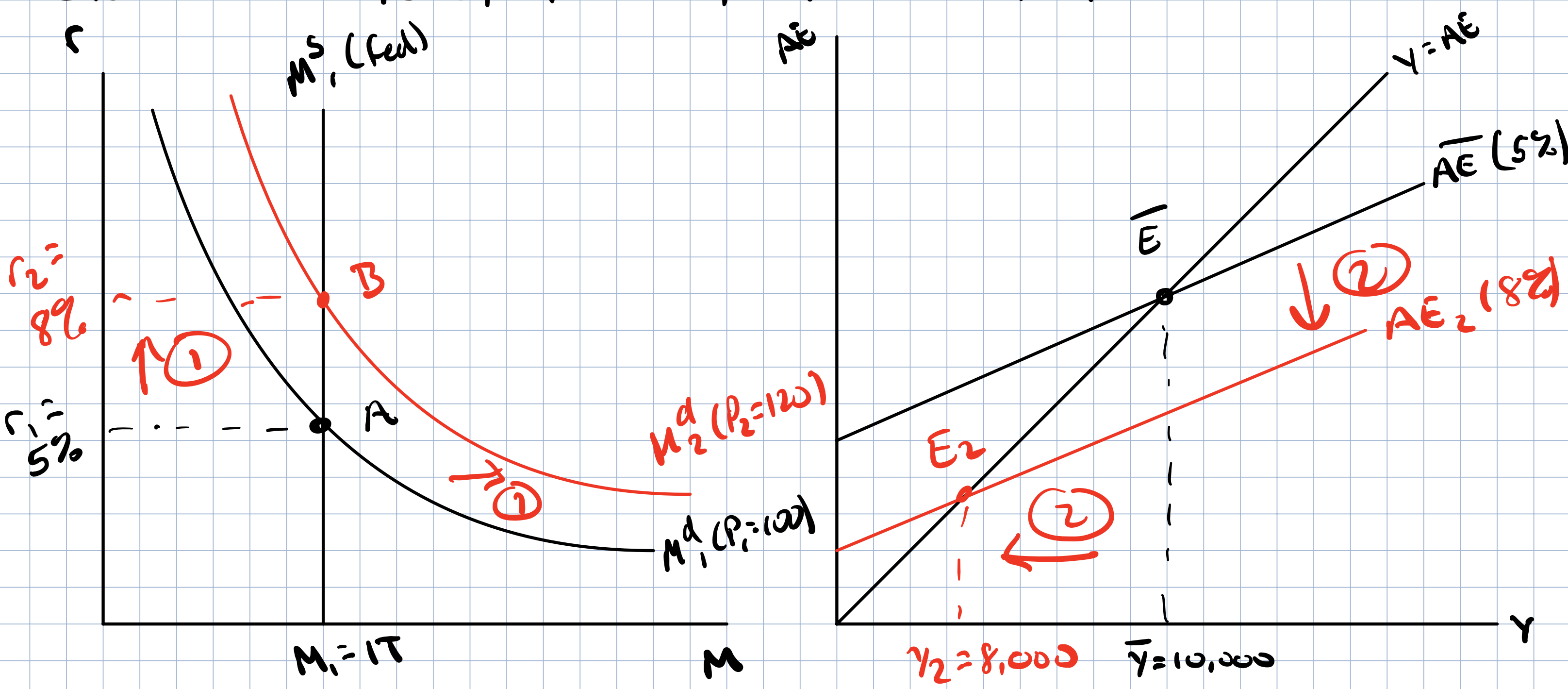
Purpose of Exam: Test understanding ⇒ unique looking questions

More practice problems ⇒ More unique exam questions

Final Week: Complete Macroeconomic Equilibrium

Last Class: Why is inflation a problem

Start at $\bar{Y} = 10{,}000$, $r_1 = 5\%$, $M_1 = 1$ Tril, $P_1 = 100$



Prices Rise from $P_1 = 100$ to $P_2 = 120$

1) Prices rises, M^d increases to $M^d_2 (P_2 = 120)$, r_1 to r_2

2) Increase r ⇒ Decrease in AC, I^P ⇒ ↓ AE ⇒ ↓ $\bar{Y}$ to Y_2

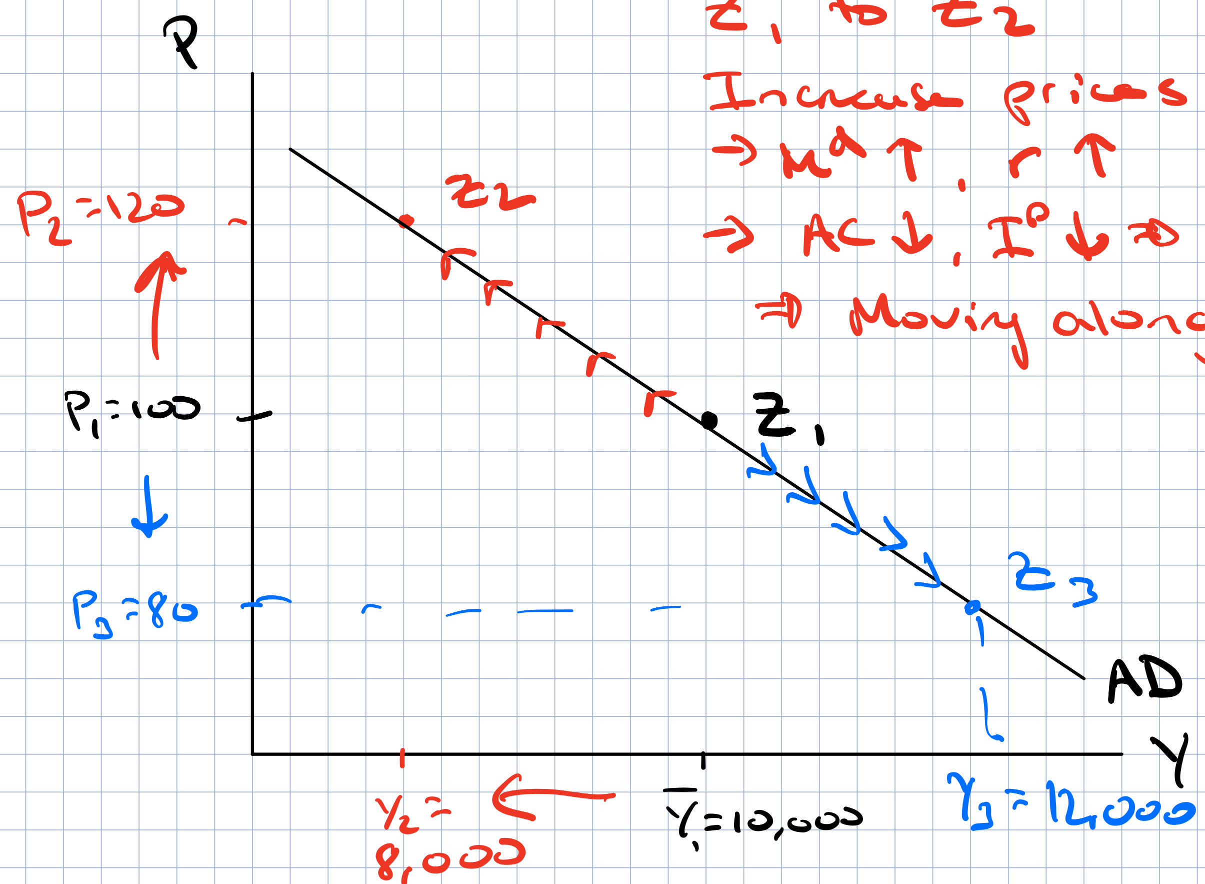
Overall:

Started at $P_1 = 100$, $\bar{Y}_1 = 10,000$
$P_2 = 120$, $Y_2 = 8,000$

As price level increase
equilibrium level of spending ($Y = AE$) decreases

Consolidate findings from money market & $Y = AE$
Shows Prices (P) vs Equilibrium Output/Spending (Y)

Z_1 to Z_2
Increase prices from 100 to 120
$\Rightarrow M^d \uparrow$, $r \uparrow$
$\Rightarrow AC \downarrow$, $I^p \downarrow \Rightarrow AE \downarrow \Rightarrow Y \downarrow$
$\Rightarrow$ Moving along AD



Z_1 represents equilibrium in Money & $Y = AE$
$\rightarrow P_1 = 100 \Rightarrow r_1 = 5\% \Rightarrow \bar{Y} = \bar{AE}$ @ 10,000

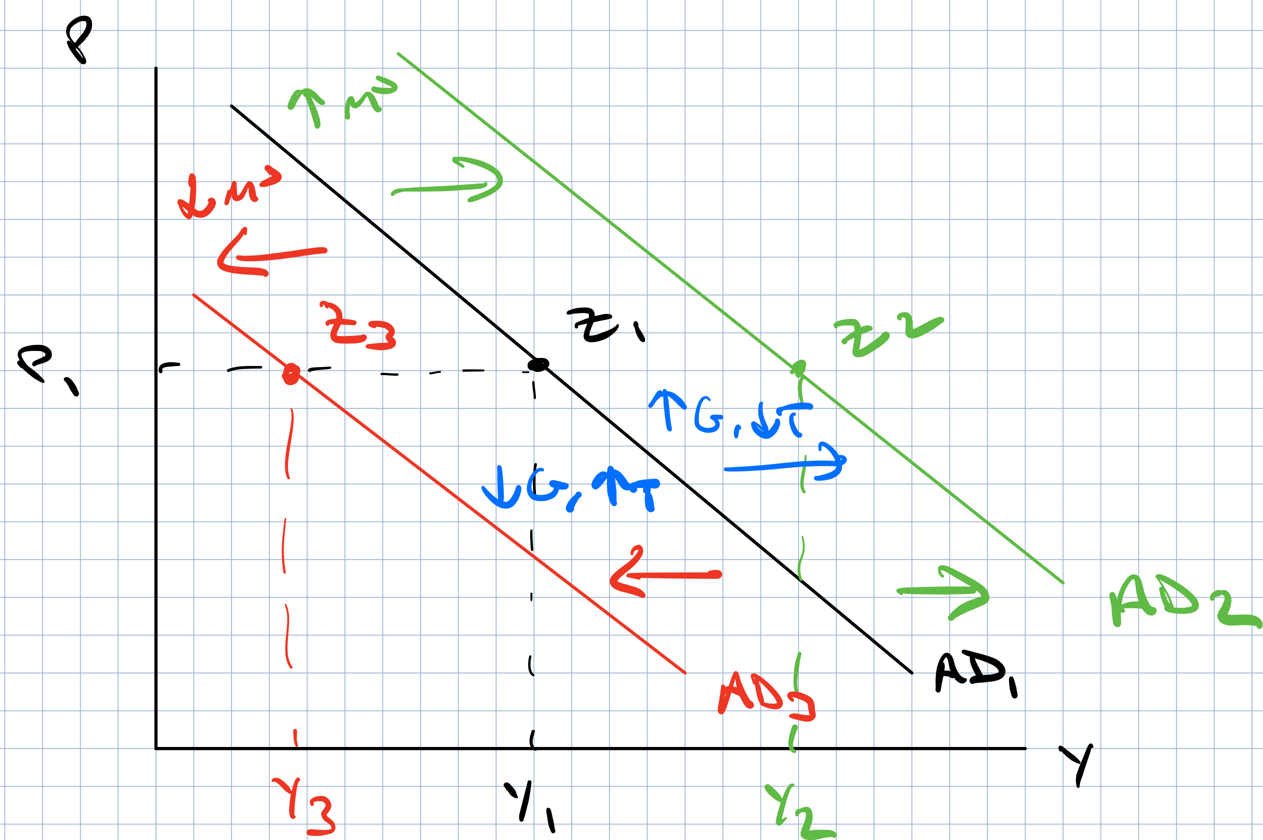
"Equilibrium level of spending at all prices" curve

Aggregate Demand Curve (AD): Prices vs. $Y = AE$

Does Aggregate Demand ever shift?

What shifts AD curve?

What changes AE other than price?



Categories of AD Shifters

1.) Monetary Policy

$\Rightarrow M^S \uparrow$ (Buy bonds) $\Rightarrow r \downarrow \Rightarrow AE \uparrow \Rightarrow Y \uparrow \Rightarrow AD \uparrow$ (right)

$\Rightarrow$ General prices of goods are the same (initially)

$\Rightarrow M^S \downarrow$ (sell bonds) $\Rightarrow Y \downarrow \Rightarrow AD \downarrow$ (Left)

2) Fiscal Policy

$\Rightarrow \uparrow G$ or $\downarrow T \Rightarrow AE \uparrow \Rightarrow \uparrow Y$, no change in P

$\hookrightarrow \uparrow AD$ (right)

$\Rightarrow \downarrow G$ or $\uparrow T \Rightarrow \downarrow Y$, no change in P $\Rightarrow \downarrow AD$ (left)

3.) Word Cloud

⇒ Direct change in I^P, G, NX, AC

⇒ Consumer confidence increases ⇒ ↑AE, ↑Y

↳ Prices today are the same ⇒ ↑AD (Right)

⇒ Pandemic / Lockdown ⇒ ↓AD

⇒ Housing Crash ⇒ ↓AD

Add other side of market prices & output

AD: Consumer Spending & Prices

Aggregate Supply (AS):

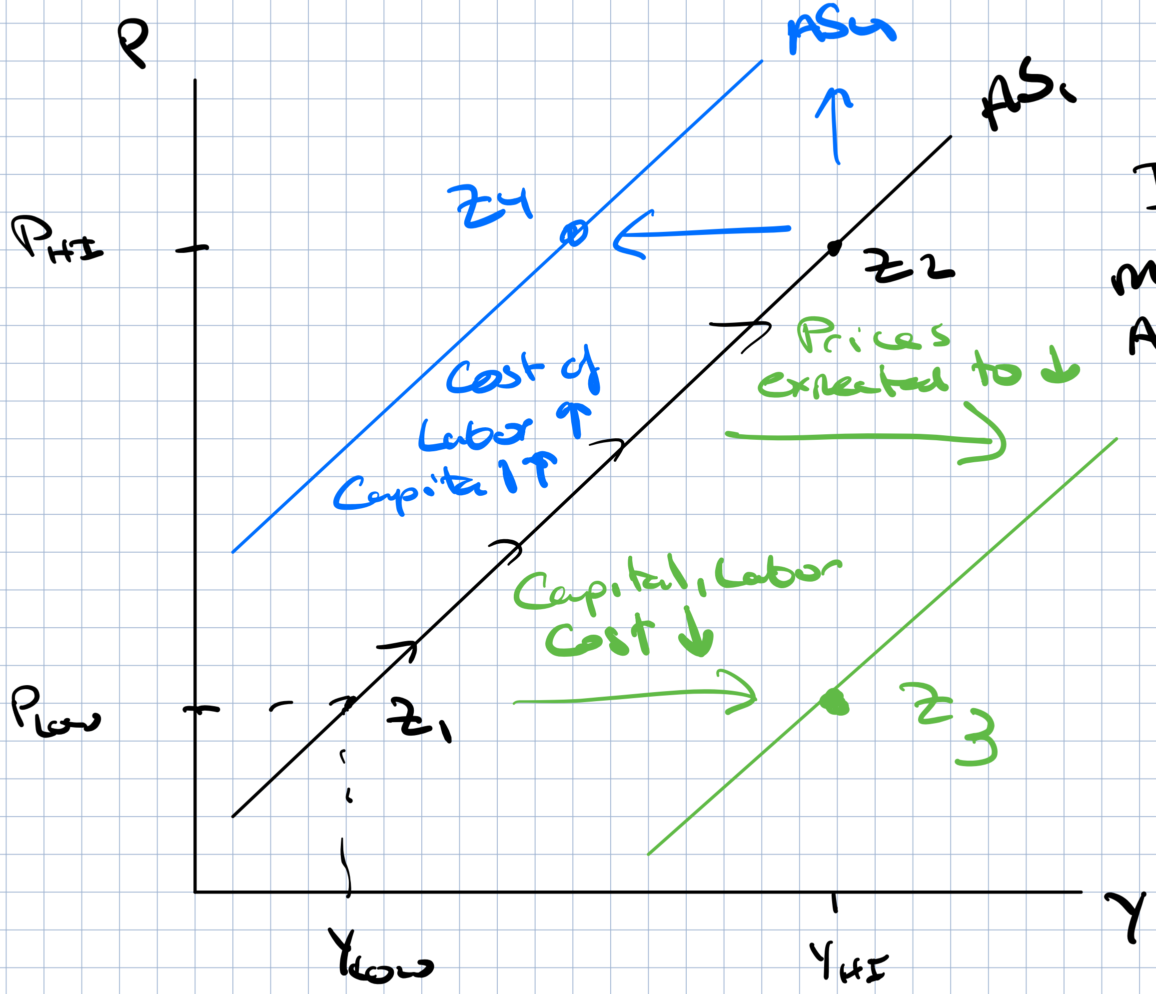
How will firms change production (Y) in response to price changes (P)?

Econ 1 / Chapter 2:

Quantity supplied: amount a firm is willing & able to produce / sell at a given price

As P↑, Y↑ } Entire economy,
As P↓, Y↓ } aggregate up for all firms

AS: Plot relationship between general price level & output

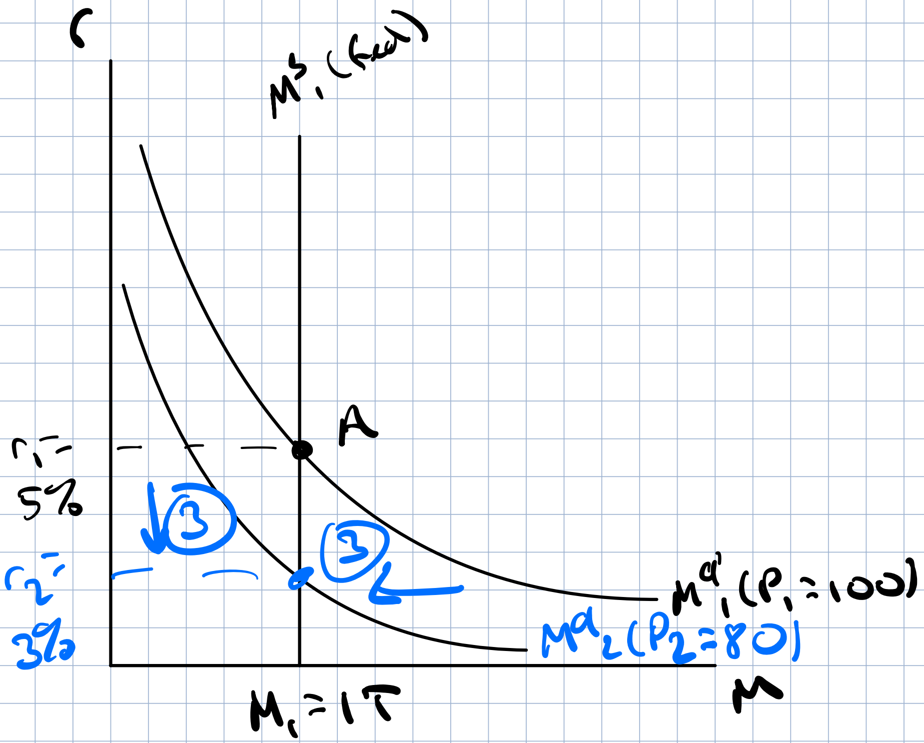


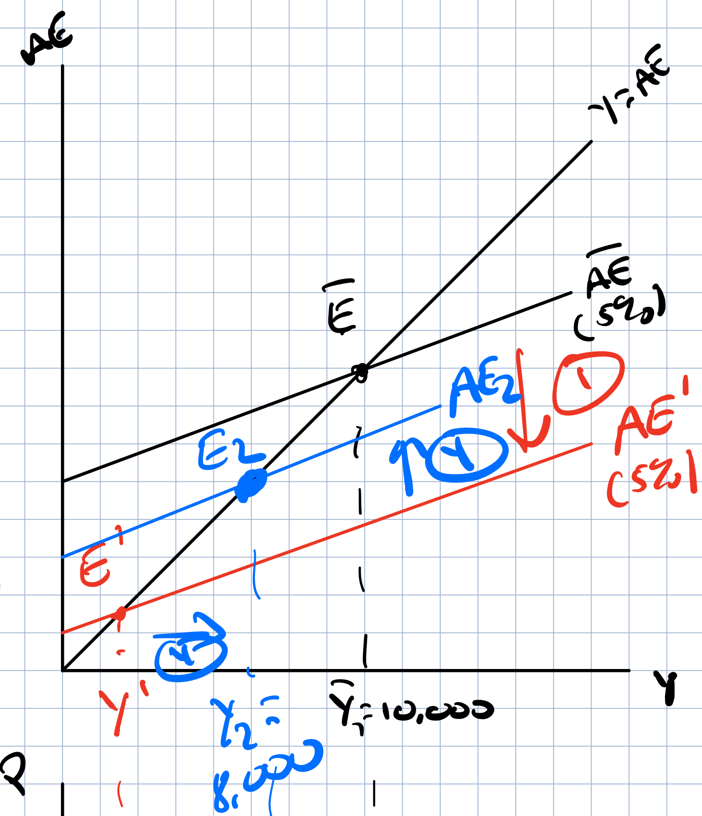
In order to move along AS → P changes
Y changes

Shifts in AS:
- → Cost of Inputs: Labor (wages) & Capital
- → Expectations
- → Technology ⇒ makes capital more productive (↑Y)
- → # of firms
- → Regulations / Tariffs
- → Weather

Complete Macroeconomic Equilibrium

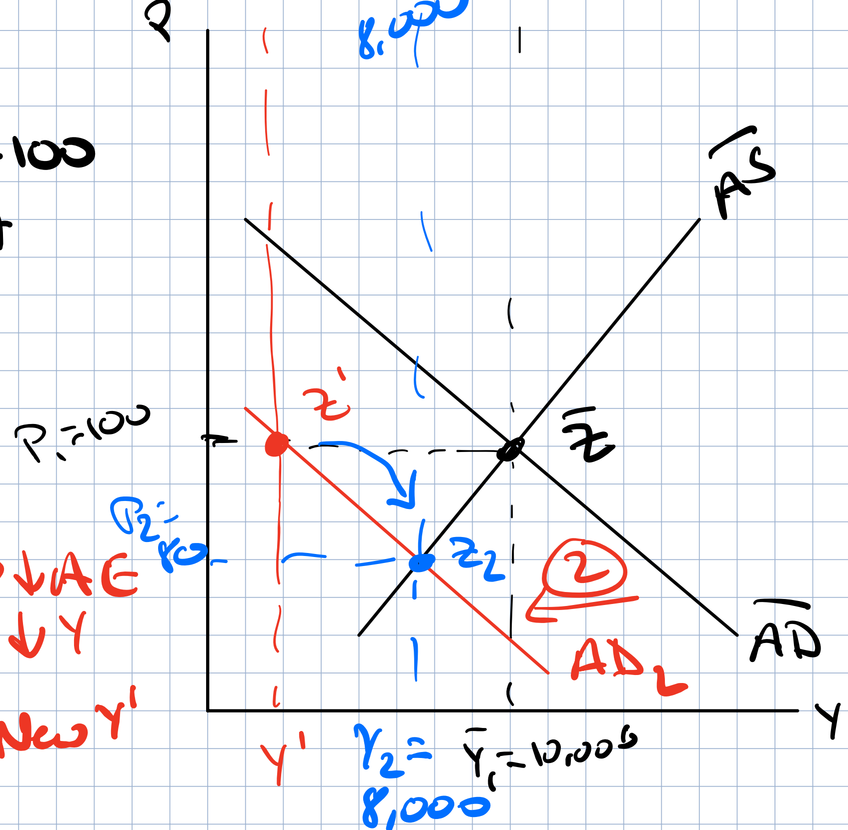
$M_1^s = 1$ Tril, $r_1 = 5\%$, $\bar{Y}_1 = 10{,}000$, $P_1 = 100$





Firms must be willing to produce $\bar{Y} = 10{,}000$ at $P_1 = 100$

No pressure for any part of economy to move



Analyze Housing Crash

1) ↓ wealth, ↓ AC, ↓ I^P ⇒ ↓ AE
↓ Y

2) Prices initially $P_1 = 100$, New Y'
⇒ ↓ AD (Shift)

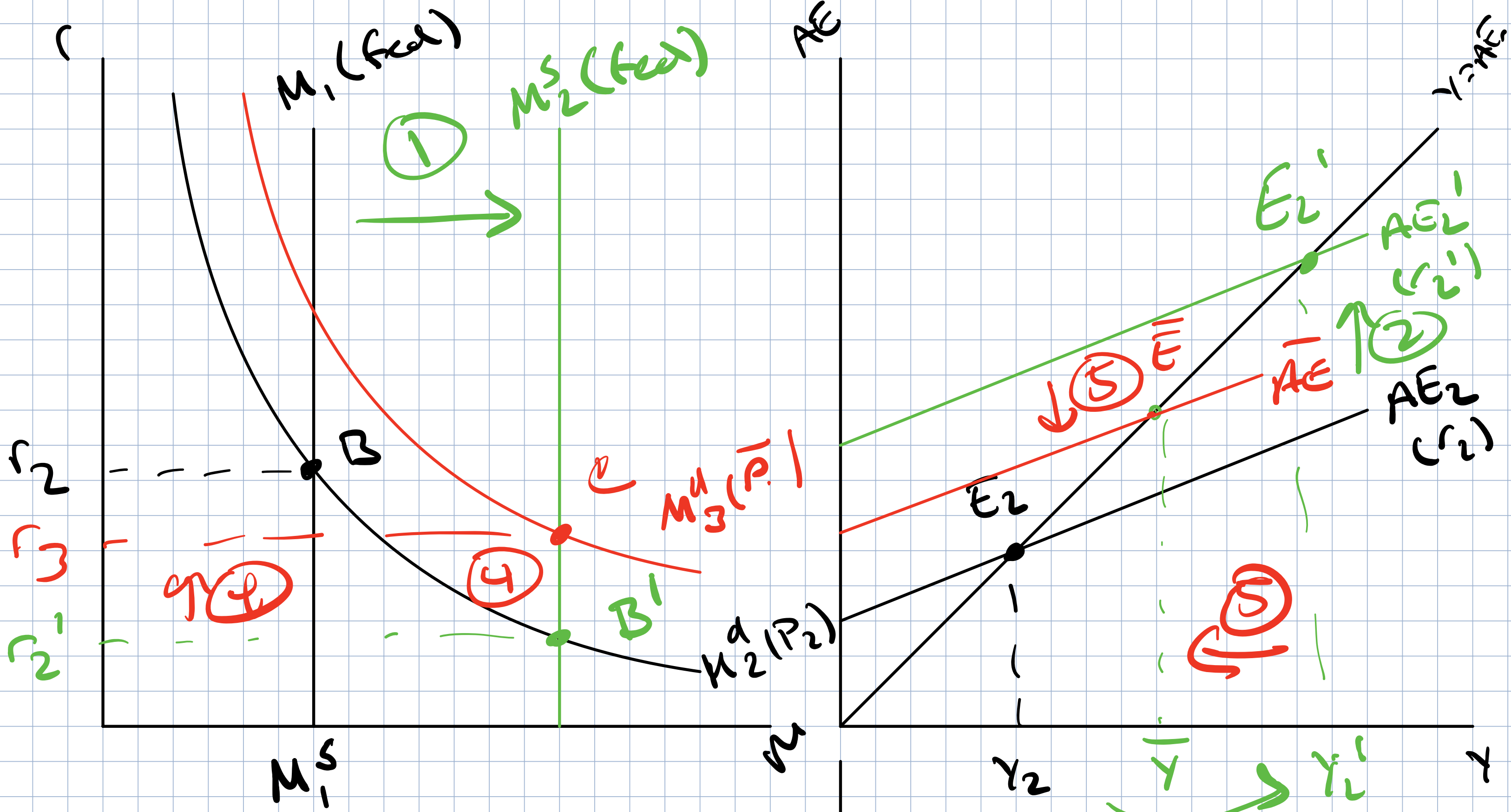
3) Downward pressure on prices, P↓, M^d↓, r↓

4) ↑ AC, ↑ I^P ⇒ ↑ AE, ↑ Y to $Y_2 = 8{,}000$

Housing Crash ⇒ ↓Y (lower GDP)

↓P (lower prices)

Start at $Y_2 < \bar{Y}$, r_2, $P_2 < \bar{P}_1$, $M^s_1 = 1T$, $M^d_2(P_2)$



Buy bonds!

1) $\uparrow M^s \Rightarrow \downarrow r_2$ to r_2'

2) $\uparrow AC, \uparrow I^P \Rightarrow \uparrow AE, Y$

3) Prices initially unchanged $P_2 \Rightarrow Y_2' \Rightarrow$ AD shifted right

4) Prices rise, P_2' to P_3 $\rightarrow \uparrow M^d, \uparrow r$

5) $\downarrow AC, \downarrow I^P \Rightarrow \downarrow AE$ back to $\bar{Y}$