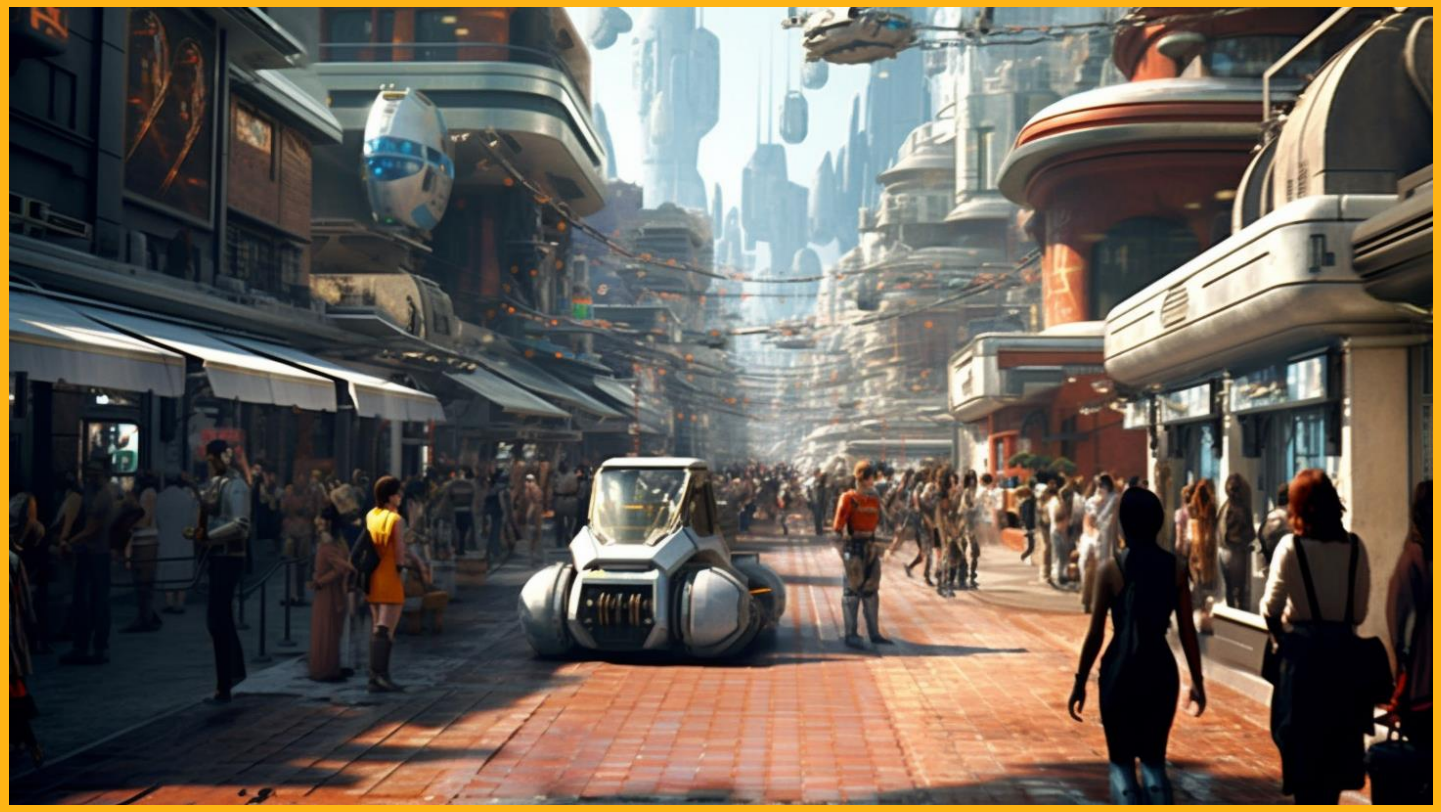
ECON 2:
Principles of Macroeconomics

Lecture 9: Short-Run Macroeconomics



Spending =
Production = Output = Income



- GDP =
  - Production(Expenditure)
  - Income(Factor Payments)
  - Firm-Value(Value-Added)
- Introduce Aggregate expenditures = total spending in the economy = AE
- Short-Run Macroeconomic Equilibrium:
  - Output = Aggregate Expenditures, Y = AE
- Goal: Explain why a particular equilibrium level of output (Y) is occurring by examining changes in AE
- Bigger Goal: get economy back to full-employment equilibrium output:
  - Y - Bar

Define Spending in the Economy

Break down spending in the economy based on categories of spenders

Household consumption = Consumption = C

What determines how much a household spends?

1. Income/Disposable Income

2. Wealth

Define Spending in the Economy

Household consumption = Consumption = C

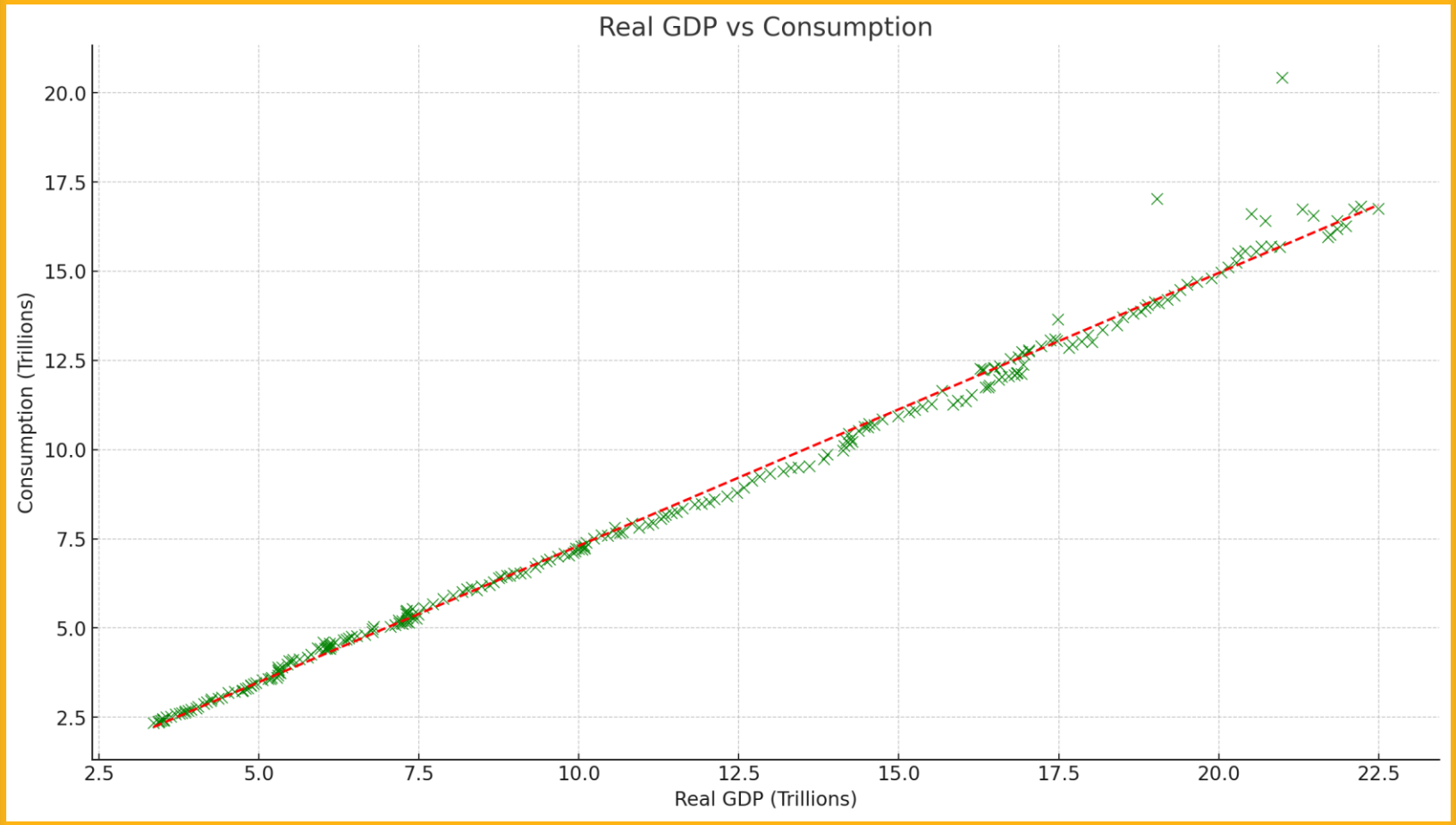
What determines how much a household spends?

3. Interest Rate

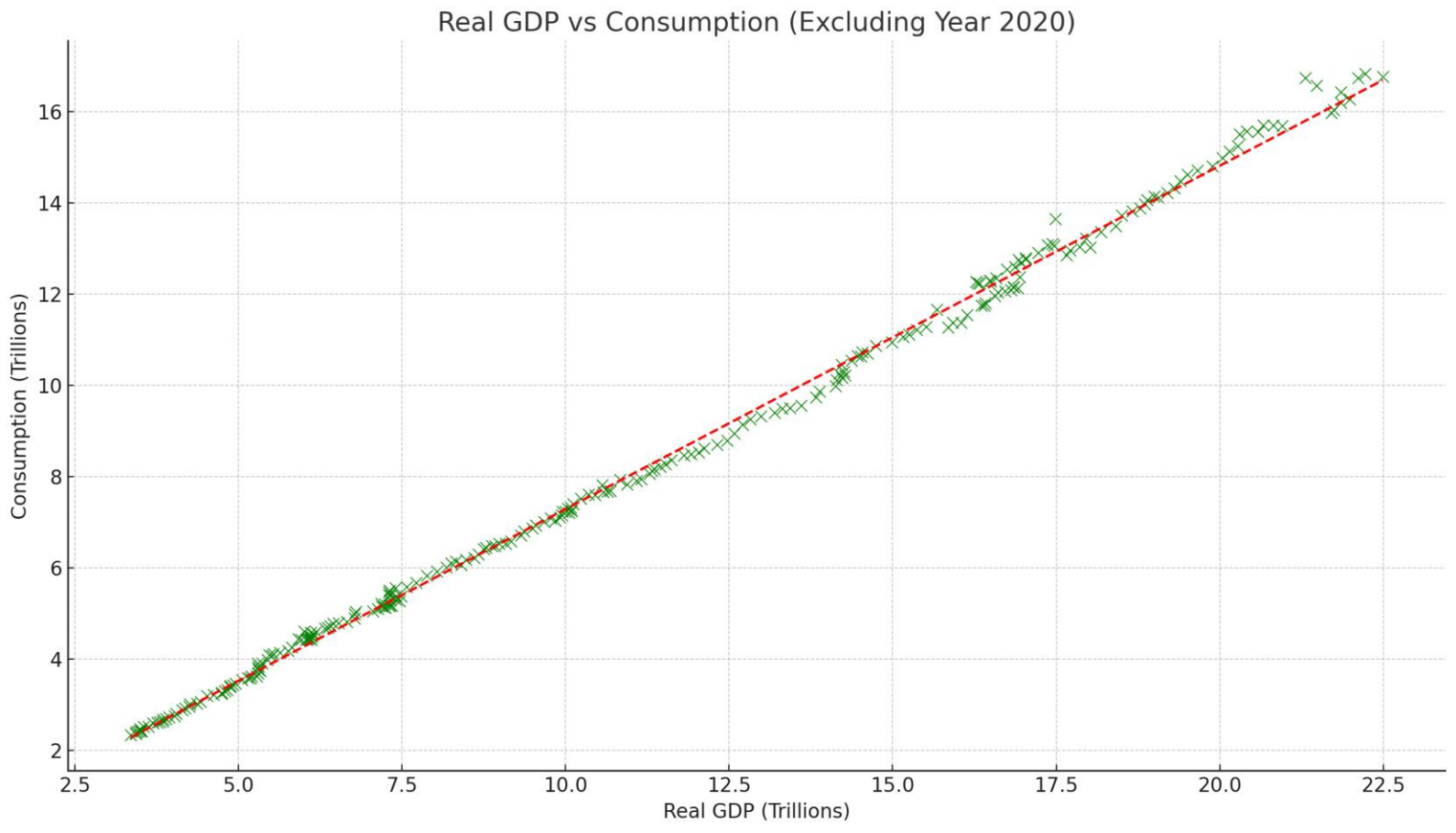
4. Expectations

5. Preferences

How Important is Income (Y)?



How Important is Income (Y)?



Disposable Income and Consumption

- The Relationship between Disposable Income and Consumption:

		Real Disposable Income	Consumption
		0	2000
		2000	3200
		4000	4400
		6000	5600
		8000	6800
		10000	8000

Disposable Income and Consumption

Autonomous Consumption (AC):

Marginal Propensity to Consume (MPC):

Consumption Function

- Consumption Function

		Real Disposable Income	Consumption
		0	2000
		2000	3200
		4000	4400
		6000	5600
		8000	6800
		10000	8000

Consumption Function

- Disposable Income vs. Consumption

Consumption Function

- Consumption Function:

Income (Y)	Taxes (T)	Real Disposable Income	Consumption
2000	2000	0	2000
4000	2000	2000	3200
6000	2000	4000	4400
8000	2000	6000	5600
10000	2000	8000	6800
12000	2000	10000	8000

Consumption Function

- Income vs. Consumption, holding taxes constant

Consumption Function

- What changes the consumption function?

Additional Types of Spending

Spending by businesses

Planned Investment Spending (I^P)

Two Major Categories:

1.

2.

What is “unplanned investment”?

Determinants of Planned Investment Spending (I^P):

1.
2.
3.

Assumption: Output today (Y) doesn't directly affect I^P

As Y changes, I^P is constant!

Spending by the Government = Government Expenditures (G)

What is included?

-Military
-Fire and Police
-Public Education
-Parks and Rec
-Highway infrastructure

Industries that produce necessary goods/service, but have trouble making a profit

Does not include *Transfer Payments* such as:

-Social Security/Welfare
-Financial Aid
-Subsidies

Assumption: Output today (Y) doesn't directly affect G

As Y changes, G is constant!

Additional Types of Spending

Spending by the Foreigners

Net Exports (NX) = Exports (X) – Imports (M)

Assumption:

Output (Y) in the short-run does not directly affect Net Exports (NX)

Aggregate Expenditures

Total Spending in the Economy = Aggregate Expenditures = AE

AE = Consumption + Planned Investment + Gov't Expenditures + Net Exports

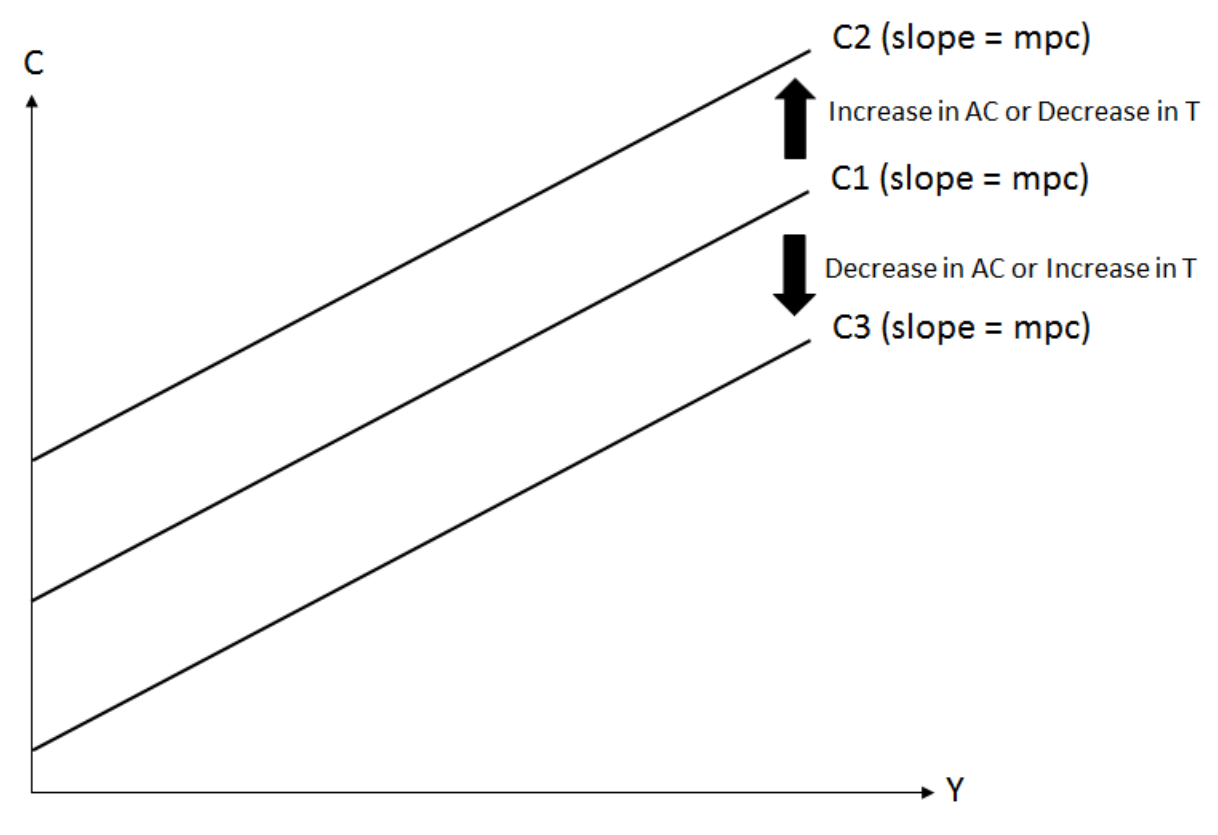
AE = C + I^P + G + NX (Note: I^P = I when change in inventories = 0)

Show how spending (AE) changes when Y changes and find where Y = AE

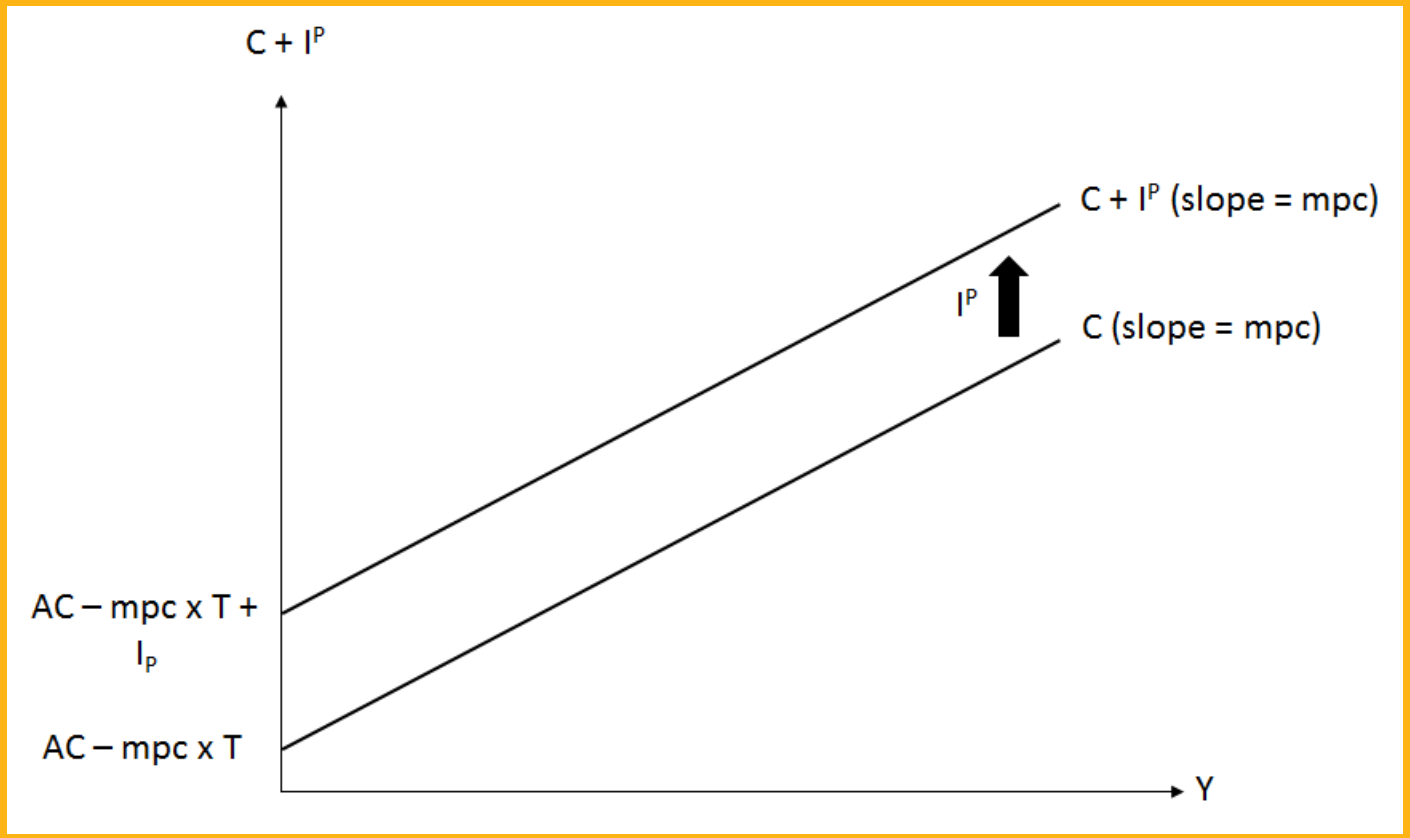
AE = AC + mpc (Y – T) + I^P + G + NX

Building the Aggregate Expenditure Curve

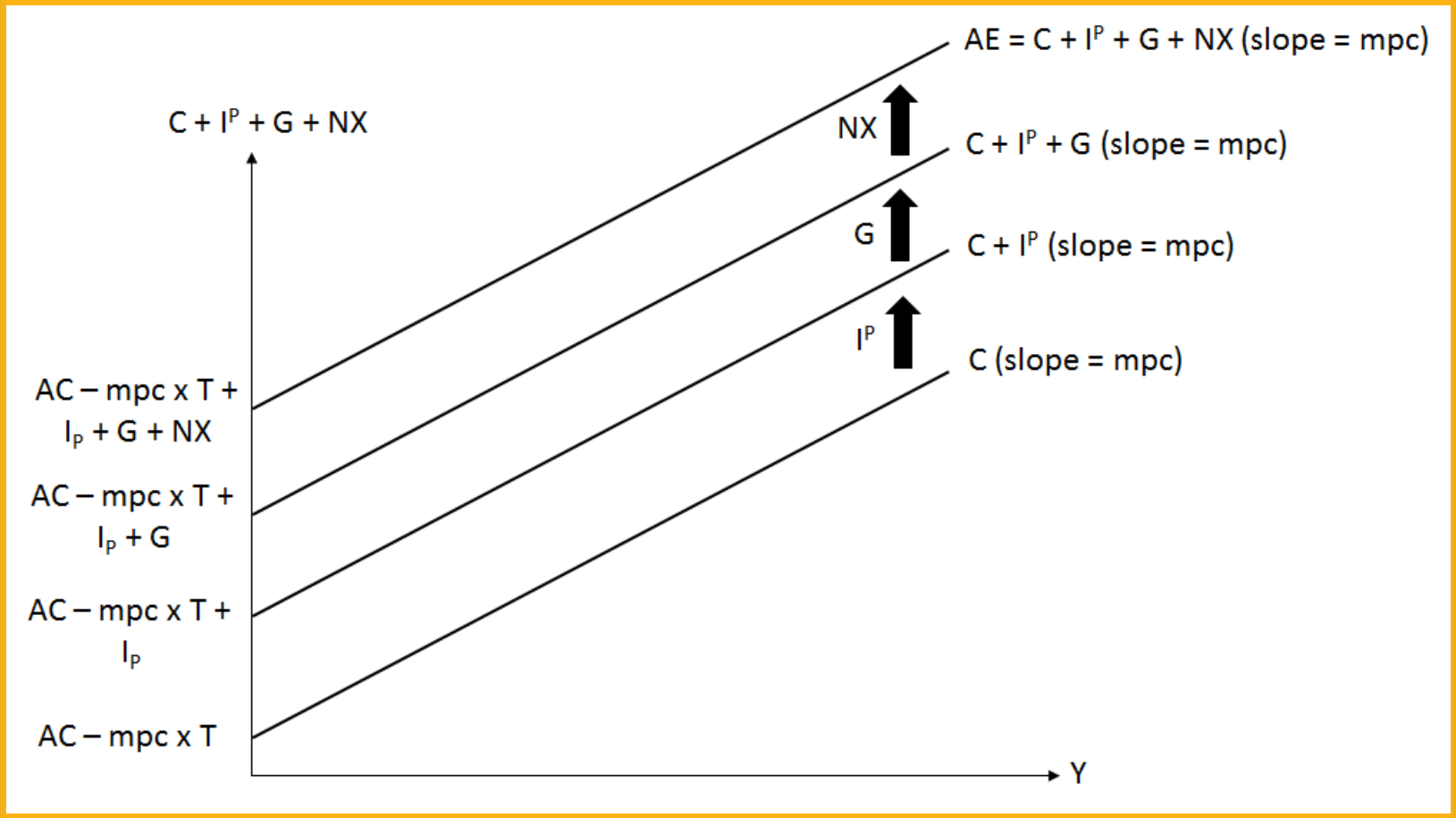
Start with Consumption



Building the Aggregate Expenditure Curve



Building the Aggregate Expenditure Curve



Where is equilibrium?

- Scenario 1: Y = 12000, but AE = 11000
  - Unsold production?
- Scenario 2: Y = 8000, but AE = 9000
  - Meeting consumer demands without production?
- Scenario 3: ?

Graphing Equilibrium