

2.2.1 Characteristics of Aggregate Demand

AD Overview

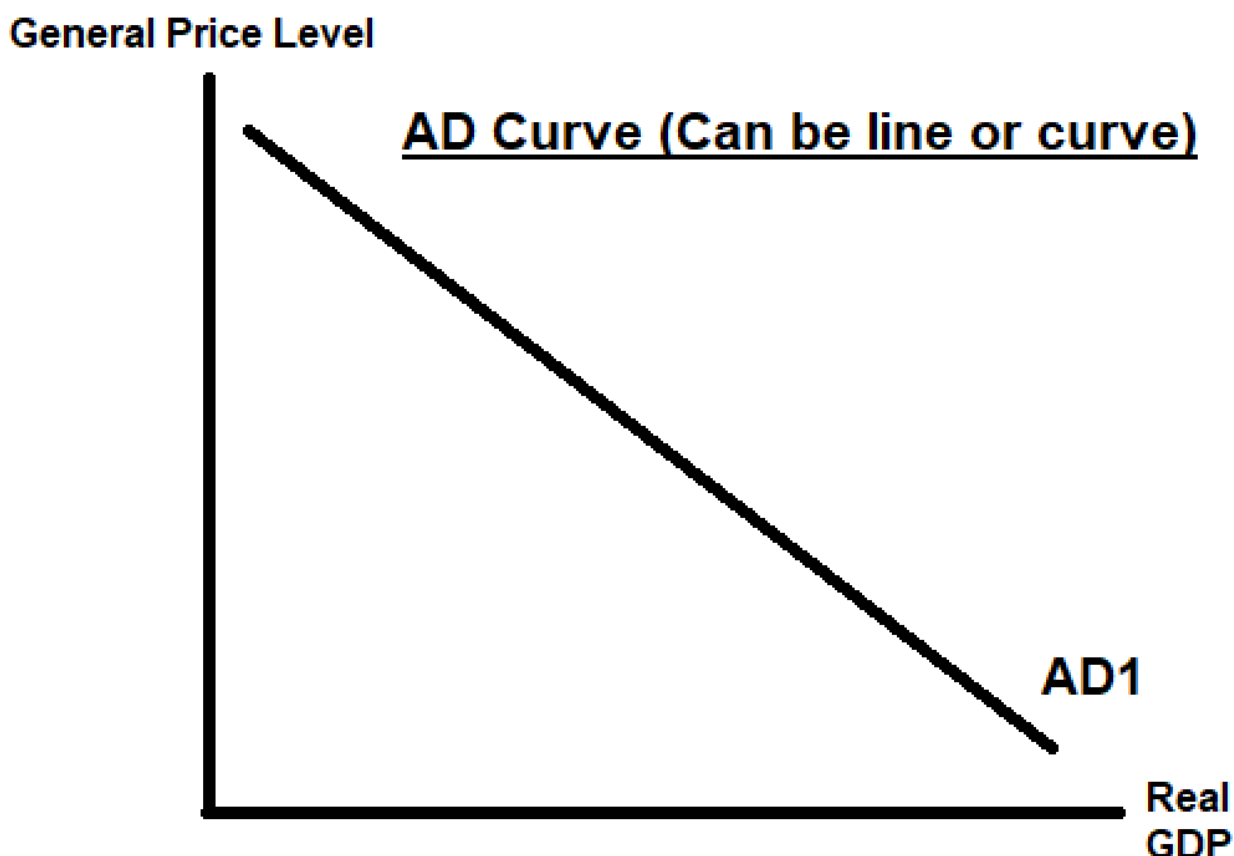
- Aggregate demand is the total demand for goods and services in an economy at in a given time period
- $AD = C + I + G + (X - M)$

Relative Importance of AD Components

- Consumption is the largest factor and makes up 60-70% (63.5% Sep 2022)
- Government expenditure is usually about 25% of AD but during 2008 and 2020 it rose significantly (partially due to a fall in AD)
- Investment accounts for about 15% of the economy however fluctuates cyclicly

- Net trade fairly insignificant (about 1-5%)

AD Curve



- As prices fall, real output/gdp increases

AD Curve - Downward Sloping

- Real Balance effect
 - Prices rise
 - Purchasing power of cash falls

- Output demanded falls (contraction in AD)
- International trade effect
 - Prices rise (relative to other countries)
 - UK international competitiveness falls
 - UK exports become more expensive to foreigners and imports become cheaper to domestic citizens
 - X falls, M increases
 - Leads to a contraction in AD
- Interest rate effect (assumes constant money supply)
 - Prices rise
 - Demand for money increases
 - Interest rates rise
 - Consumption and Investment fall
 - Leads to a contraction in AD

AD Movements along the Curve (Contraction and

Expansion)

- Caused by a change in the General Price Level
- A decrease in oil prices leads to lower costs of production leading to a fall in prices and expansion of AD

AD Shifts

- Occurs when any components change and not simply the GPL
- An increase in AD leads to a right shift, meaning that AD is higher at every price level. A left shift occurs for a decrease in AD