Aggregate Demand

**Intertemporal substitution effect** A rise in the price level, other things remaining the same, decreases the real value of money and raises the interest rate.

Faced with a higher interest rate, people try to borrow and spend less so the quantity of real GDP demanded decreases.

Similarly, a fall in the price level increases the real value of money and lowers the interest rate.

Faced with a lower interest rate, people borrow and spend more so the quantity of real GDP demanded increases.
- Inter-temporal substitution effect
- IS-LM model

Next page

For a fuller understanding take Econ 302

- Fisher 2 period model

Not discussed.

For a fuller understanding take Econ 402

Question: Is there a consensus view as to what determines AD? No
The IS-LM model

The diagram shows the IS curve and the AD curve. The IS curve represents the intersection of the investment and saving curves, while the AD curve represents the aggregate demand for goods and services.

- Narrower focus: $\Delta$ Net Worth $\equiv \Delta \left( \frac{1}{P} \right)$
- Broader focus: Incorporation of money and foreign exchange markets