Aggregate Demand

Changes in Aggregate Demand

A change in any influence on buying plans other than the price level (aggregate demand curve).

The main influences on aggregate demand are:

- Expectations
- Fiscal and monetary policy
- The world economy

Note: An increase in AD \(\equiv\) a rightward shift in AD.
Aggregate Demand

Figure 6.7 illustrates changes in aggregate demand.

When aggregate demand increases, the $AD$ curve shifts rightward...

... and when aggregate demand decreases, the $AD$ curve shifts leftward.
Aggregate Demand

Expectations about future income, future inflation, and future profits change aggregate demand.

Increases in expected future income increase people’s consumption today, and increases aggregate demand.

A rise in the expected inflation rate makes buying goods cheaper today and increases aggregate demand.

An increase in expected future profits boosts firms’ investment, which increases aggregate demand.
Aggregate Demand

**Fiscal policy** is the government's attempt to influence economic activity by changing its taxes, spending, deficit, and debt policies.

A tax cut or an increase in transfer payments increases households' **disposable income**—aggregate income minus taxes plus transfer payments.

An increase in disposable income increases consumption expenditure and increases aggregate demand.
Aggregate Demand

Because government purchases of goods and services are one component of aggregate demand, an increase in government purchases increases aggregate demand.

**Monetary policy** is changes in the interest rate and quantity of money.

An increase in the quantity of money increases buying power and increases aggregate demand.

A cut in the interest rate increases expenditure and increases aggregate demand.
The world economy influences aggregate demand in two ways:

A fall in the foreign exchange rate lowers the price of domestic goods and services relative to foreign goods and services, increases exports, decreases imports, and increases aggregate demand.

An increase in foreign income increases the demand for U.S. exports and increases aggregate demand.