Aggregate Demand

International substitution effect. A rise in the price level, other things remaining the same, increases the price of domestic goods relative to foreign goods, so imports increase and exports decrease, which decreases the quantity of real GDP demanded.

\[ R = \frac{\text{CPI}_{\text{U.K.}} \times e}{\text{CPI}_{\text{U.S.}}} = \frac{\% \text{heir} \times \%}{\% \text{heir}} \]

\[ e = \frac{\% \text{heir U.K.}}{\% \text{heir U.S.}} \]

\[ R = \frac{\% \text{heir U.K.}}{\% \text{heir U.S.}} \]

\[ e = \frac{\text{Price of a haircut in U.K.}}{\text{Price of a haircut in U.S.}} \]

\[ R = \text{nominal exchange rate} = \frac{\text{cost in } \% \text{ of one unit of foreign currency}}{\text{real exchange rate}} \]

\[ R = \frac{\% \text{cost of a comparable good or service bought abroad}}{\% \text{in U.S.}} \]

\[ R > 1.0 \text{ then U.S. is competitive} \]

\[ R < 1.0 \text{ then U.S. is not competitive} \]