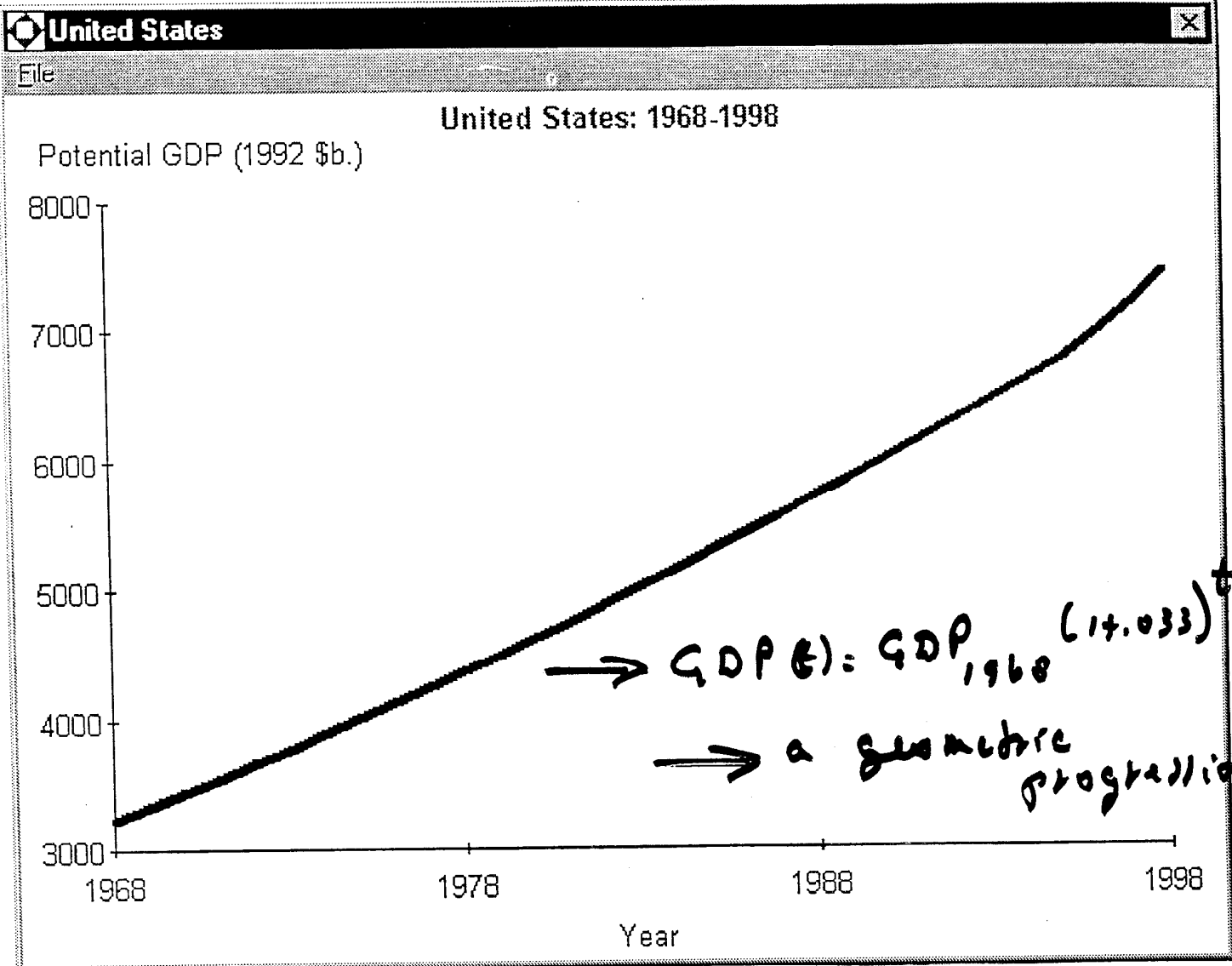


→ Potential RGDP

• how has Pot RGDP behaved

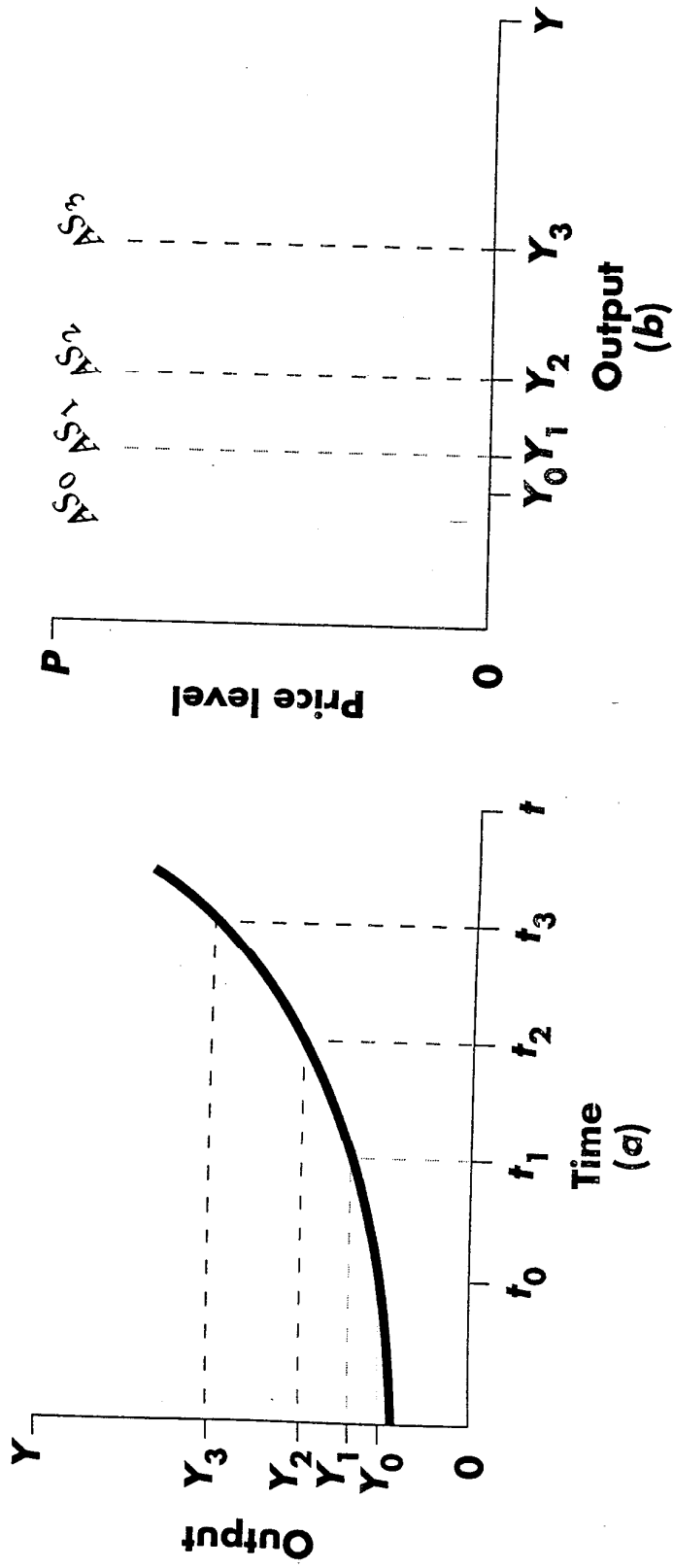
• Give an explanation



Q: has potential GDP increased rather steadily?

• give an explanation "growth theory"

FIGURE 1-4
DETERMINATION OF AGGREGATE SUPPLY: THE VERY LONG RUN



Economic growth perspective

real savings = $S \equiv I$ = real investment
 \equiv newly produced
durable goods

$$S + C \equiv I + C$$

$$Y \equiv AD$$

$$AS \equiv AD$$

- Say's Law holds at all times

- $AS^{\text{Planned}} \equiv AD^{\text{Planned}}$

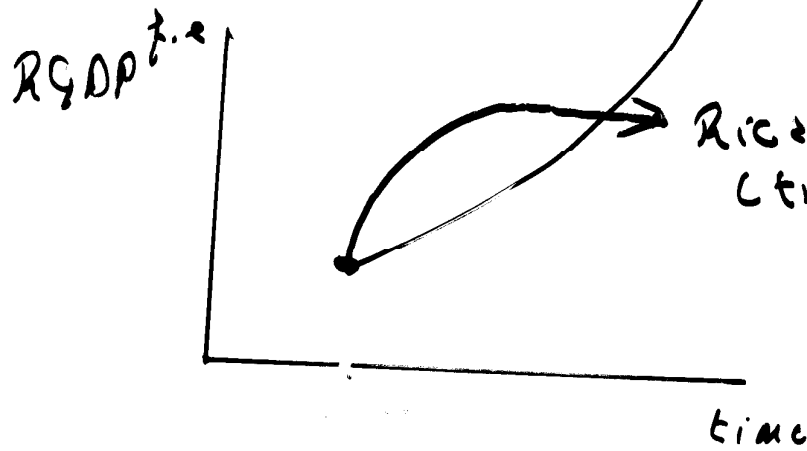
$AS \equiv AD \equiv P_{ot} RGDP$

- you are all that you can be all the time!

$P_{ot} RGDP$

economic growth formula

$$\frac{\Delta \text{RGDP}^{t.e.}}{\text{RGDP}^{t.e.}} = f(t)$$



Ch. 4
New Classical
Lucas
Neo Classical
Solow
Ch 3.

Ricardo
(true classical)

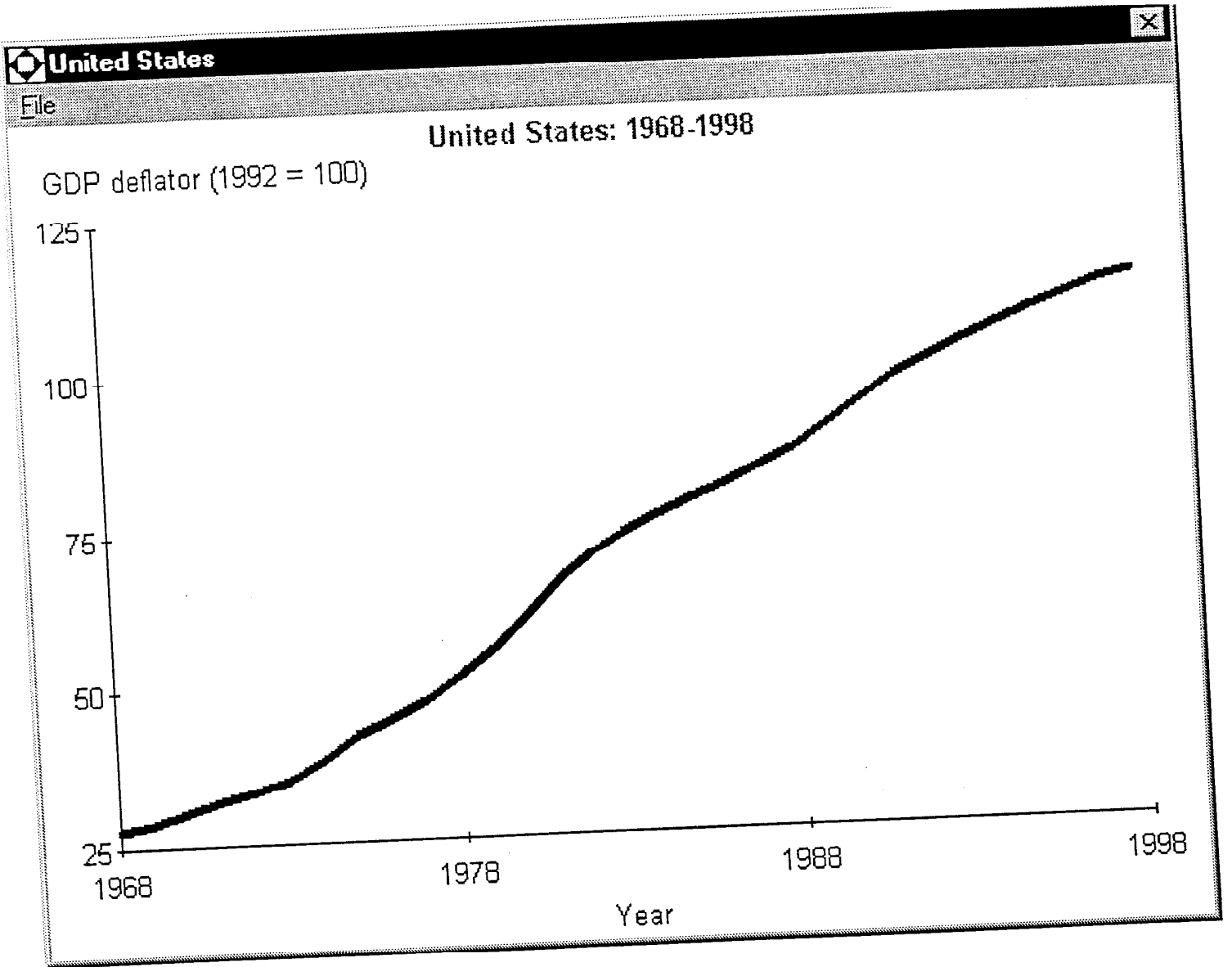
time in and by itself explains nothing

theory please!

$$\frac{\Delta Y}{Y} = \frac{S}{k} = \frac{\frac{S}{Y}}{\frac{Y}{k}} = \frac{S}{k} = \frac{I}{k} = \frac{\Delta K}{K}$$

$$\longrightarrow \frac{\Delta Y}{Y} = \frac{\Delta K}{K}$$

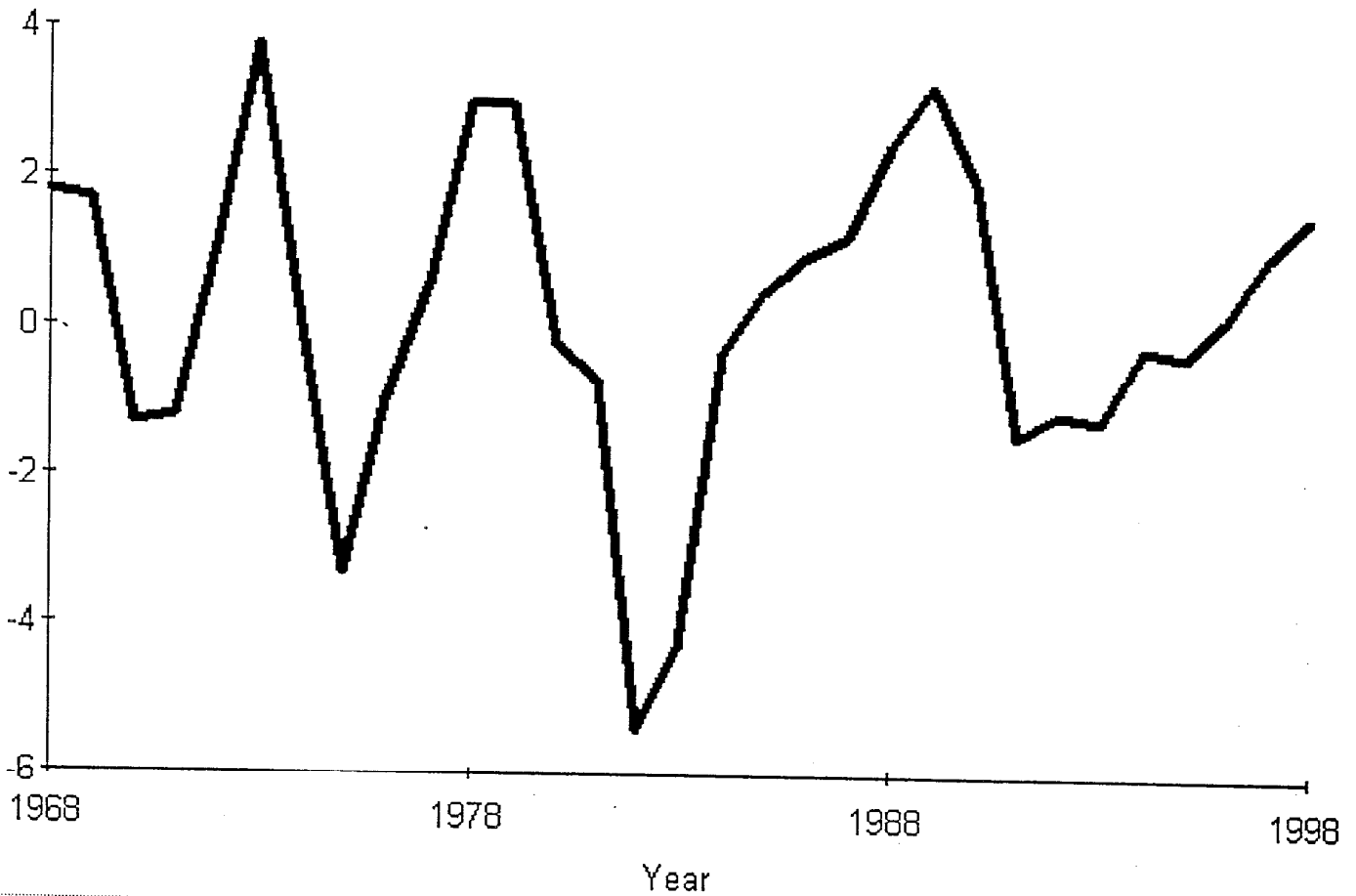
\longrightarrow what about
technological
progress etc.?



Q: have prices increased rather steadily?

United States: 1968-1998

Fluctuations around potential GDP (%)



Q: have fluctuations around
nat. GDP been substantial?

1. IS/LM Closed Economy

GNP Identity: $Y = C + I + G$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = 1583Y - 10R$

Price Level: $P = 1.00$

Government Deficit: $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*)/Y^* * 100$

in fyllebus

$T = .188Y$
 $\rightarrow Y^d = (Y - T)$

2. Fixed Price Model; Open Economy; Flexible Exchange Rate

GNP Identity: $Y = C + I + G + X$

Disposable Income: $Y^d = (1.0 - 0.188)Y$

Consumption: $C = 200 + .7754Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .1583Y - 10R$

Price Level: $P = 1.00$

Real Exchange Rate: $EP/P^w = 75 + .05R$

Net Exports: $X = 600 - .10Y - 1.00 EP/P^w$

Government Deficit: $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*)/Y^* * 100$

3. IS/LM Model, Open Economy, Fixed Nominal Exchange Rate

GNP Identity: $Y = C + I + G + X$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775Y Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .1583Y - 10R$

Price Level: $P = 1.00$

Real Exchange Rate: $EP/P^w = 100.0$

Net Exports: $X = 600 - .10Y - 1.00 EP/P^w$

Government Deficit: $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*) / Y^* * 100$

4. Aggregate Demand/Price Adjustment Model for a Closed Economy

GNP Identity: $Y = C + I + G$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .1583Y - 10R$

Expected π : $\pi^e = .4 \pi_{-1} + .2 \pi_{-2}$

Inflation Rate: $\pi = \pi^e + .80 (Y_{-1} - Y^*_{-1}) / Y^*_{-1}$

Price Level: $P = P_{-1} (1.0 + \pi/100.00)$

Government Deficit $GD = G - .188Y$

Unemployment Rate $U = U^* - .33 * (Y - Y^*) / Y^* * 100$

5. Aggregate Demand/Price Adjustment, Closed Economy, No Expected Inflation

GNP Identity: $Y = C + I + G + X$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .18583Y - 10R$

Inflation Rate: $\pi = 80 (Y_{-1} - Y^*_{-1}) / Y^*_{-1}$

Price Level: $P = P_{-1} (1.0 + \pi/100.0)$

Government Deficit: $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*) / Y^* * 100$

6. Aggregate Demand/Price Adjustment, Open Economy, Fixed Exchange Rate

GNP Identity: $Y = C + I + G + X$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775 Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .1583Y - 10R$

Expected π : $\pi^e + .80 (Y_{-1} - Y^*_{-1})/Y^*_{-1}$

Price Level: $P = P_{-1} (1.0 + \pi/100.00)$

Real Exchange Rate: $EP/P^W = 100.0$

Net Exports: $X = 600 - .10Y - 1.00 EP/P^W$

Government Deficit: $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*)/Y^* * 100$

7. Aggregate Demand/Price Adjustment, Open Economy, Flexible Exchange Rate

GNP Identity: $Y = C + I + G + X$

Disposable Income: $Y^d = (1.0 - .188)Y$

Consumption: $C = 220 + .775Y^d$

Investment: $I = 1000 - 20R$

Money Demand: $M/P = .1583Y - 10R$

Expected π : $\pi^e = 4\pi_{-1} + .2\pi_{-2}$

Inflation Rate: $\pi = \pi^e + .80 (Y_{-1} - Y^*_{-1})/Y^*_{-1}$

Price Level: $P = P_{-1} (1.0 + \pi/100.0)$

Real Exchange Rate: $EP/P^W = 75 + .05R$

Net Exports: $X = 600 - .10Y - 1.00 EP/P^W$

Government Deficit $GD = G - .188Y$

Unemployment Rate: $U = U^* - .33 * (Y - Y^*)/Y^* * 100$