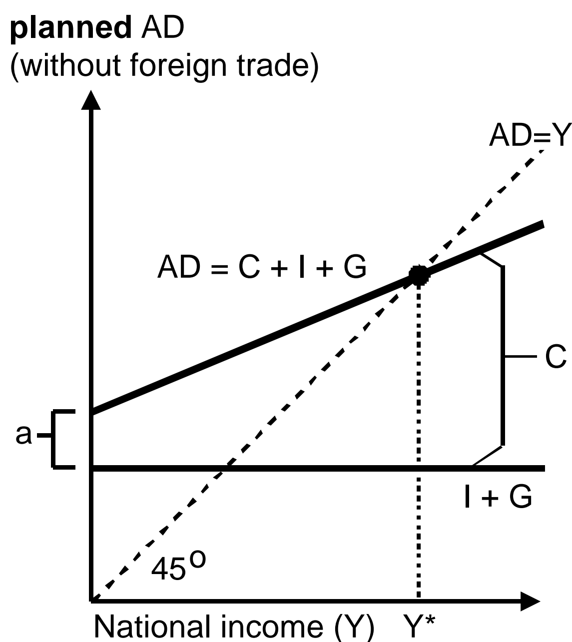
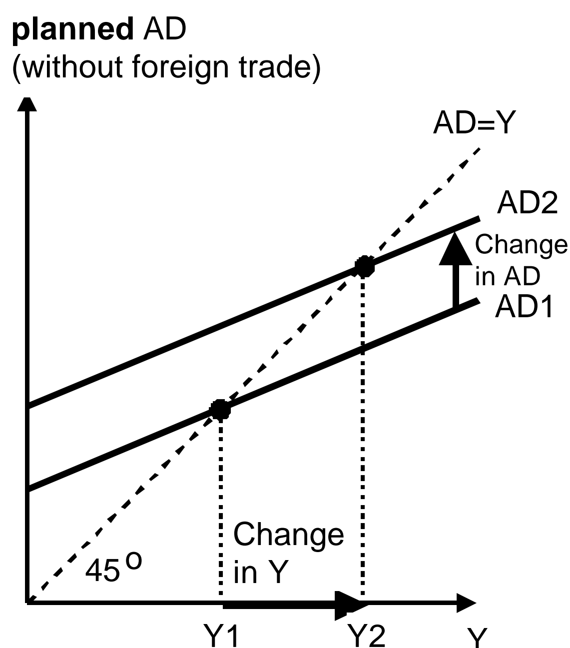
Aggregate Demand, Multiplier, and Price Level

1 Aggregate demand (Keynes)



- **Consumption (C)**
  C = a + bY (a ➡ consumption if Y = 0)
  C (apart from a) is dependent on Y.
- **Investment (I):**
  I is independent of Y, but it is dependent on interest rates and **future** AD (expectations).
- **Government spending (G):**
  G is independent of Y, but dependent on the **policy** of the government
- Y* = equilibrium national income

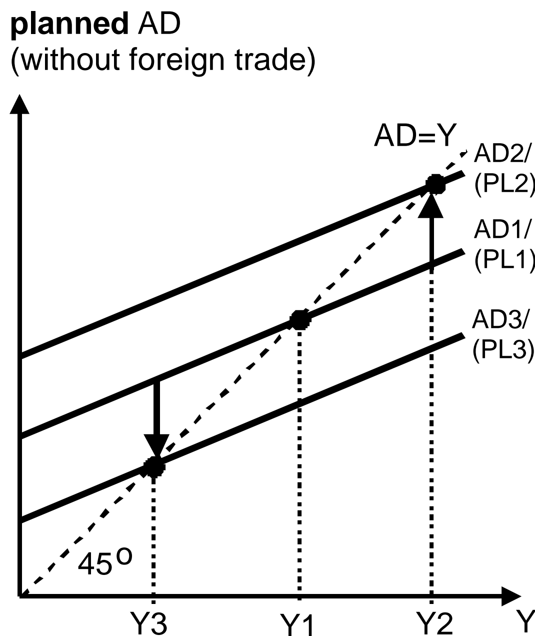
2 Aggregate demand and multiplier

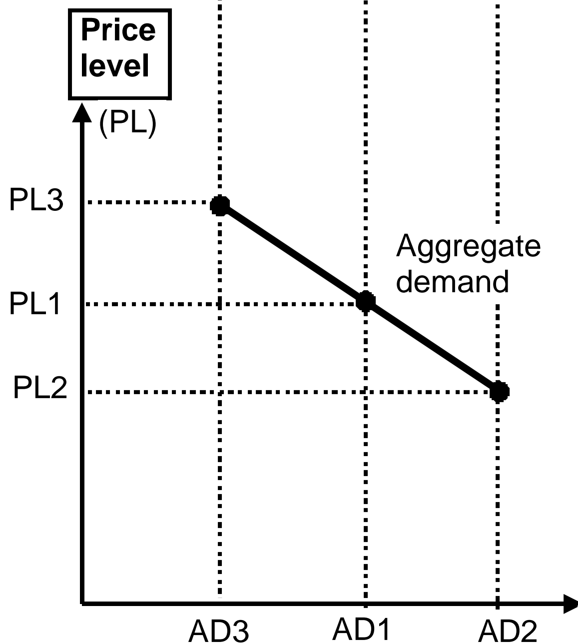


- Example:
  During a recession, G is increased. Thus, AD rises primarily by the same amount because G is part of AD. However, Y is changed more than the initial change in AD (➡ Multiplier)
- $$\text{Multiplier} = \frac{\text{Change in Y}}{\text{Change in AD}}$$

  For example, if G rises by 6 and Y by 9, the multiplier is 1.5.

3 Price level and aggregate demand





- Starting point: AD1/Price level (PL)1
- A higher price level (PL3) lowers AD from AD1 to AD3. Essentially, consumption is reduced by a higher price level.
- Due to a lower price level (PL2) AD rises from AD1 to AD2.

Thus, we can see that die **AD curve is downward sloping** (like a demand curve in a single market).

There are two main **differences** between the AD curve and the demand curve in a single market:

① The AD curve relates AD to the price **level.** The price level represents **all prices** of the AD goods.

② AD includes not only consumption goods but also **all the other goods of AD.**