Intro to Aggregate Demand (AD)

# Starter-Quick Questions

**Instructions** Test yourself with the below quick questions

What are the four primary macroeconomic objectives?

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What is meant by aggregate?

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What is meant by demand?

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# Presentation 1 - Characteristics of Aggregate Demand

Complete the activities below so as to have a complete set of notes:

**Definition:** *Aggregate Demand (AD)*

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**Link Task:** Match the different components of AD to the correct definition

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| Consumption (C) |  | Total expenditure by households on goods and services.  *Stat:*\_\_\_\_\_\_\_\_\_\_\_\_\_\_ made up 66% of UK GDP in 2018 |
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| Investment (I) |  | The value of the nation's total trade. It is the value of a nation's total exports of goods and services minus the value of all the goods and services it imports.  *Stat:*\_\_\_\_\_\_\_\_\_ made up -1% of UK GDP in 2018 (+29% for \_\_\_\_\_\_\_\_\_ -30% for \_\_\_\_\_\_\_\_\_\_\_\_). |
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| Government Expenditure (G) |  | Spending, by firms, on capital goods such as equipment and new buildings to produce more consumer goods in the future  *Stat:* **\_\_\_\_\_\_\_\_\_\_** made up 17% of UK GDP in 2018 |
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| Net Exports (X-M) |  | Spending by the government for the benefit of the country’s citizens, funded by tax revenue and borrowing.  *Stat:*\_\_\_\_\_\_\_\_\_\_\_\_\_\_made up 18% of UK GDP in 2018. |

*AD Equation:*

**Analysis:** Elaborate on the key idea below:

*A change in C has the biggest effect on AD compared to the other components.*

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# Discussion Questions: AD formula

**Instructions:**

* Individually consider the below questions
* Discuss your thoughts with a partner
* Share your ideas with the class

1. If AD is concerned with the UK economy, why do we include export demand, which is the demand from foreign consumers?

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1. Why do we subtract import expenditure, even though this represents the purchase of goods and services by British citizens?

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1. Through what mechanism does a rise in import expenditure cause a fall in AD; or a fall in import expenditure cause a rise in AD?

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# Presentation 2 – The AD curve

Complete the activities below so as to have a complete set of notes:

**Definition:** *Aggregate Demand (AD) curve*

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**Key Question:** *Why is the AD curve downward sloping?*

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**Key Notes:** Elaborate on the below analysis

*Movements along the AD curve:* Correspond to changes in price level.

A rise in price level:

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A fall in price level:

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*Shifts in the AD curve:* Correspond to shocks that directly or indirectly affect the magnitude of one or more of the different components of AD.

Endogenous Shocks:

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Exogenous shocks

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# Task: Thinking ahead - AD Components

**Instructions:**

* *In each of the following scenarios, with a partner, explain what you think the effects of the following changes will be to the AD curve*
* *Discuss your ideas with the class afterwards*

1. The increase in real investment expenditure between 2000 and 2005

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1. The cuts in government expenditure by the coalition government

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1. The large cuts in all taxes in the Lawson Budget of 1987

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1. The fall in the savings ratio from a peak of 11.5% in 1992 to 4.2% in 2004

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1. The more than 25% rise in the value of the pound against other currencies between 1996 and 2000

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1. The high inflation experienced by the UK during the mid-1970s

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1. The pushing up of interest rates by the Thatcher government, from 7.5% in May 1987 to 15% in October 1989

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1. The 50% fall in London Stock Market prices between December 1999 and January 2003

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# MCQs

**Instructions:**

* Answer the MCQs to test your knowledge of aggregate demand
* Explain your answers to further cement your understanding

**Questions:**

1. In the short run, a decrease in aggregate demand is most likely to be caused by a growth in:

1. exports
2. imports
3. consumption
4. investment

Can you explain your answer?

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|  | **Household Savings** | **Business Investment** |
| A | Rise | Rises |
| B | Rise | Falls |
| C | Fall | Falls |
| D | Fall | Rises |

2. Aggregate demand has increased in an economy. Which of the following combinations would be most likely to cause the increase?

Can you explain your answer?

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