3.2 Variations in economic activity—aggregate demand and aggregate supply (Aggregate demand)

Objectives

Aggregate demand (AD)

Components of Aggregate demand

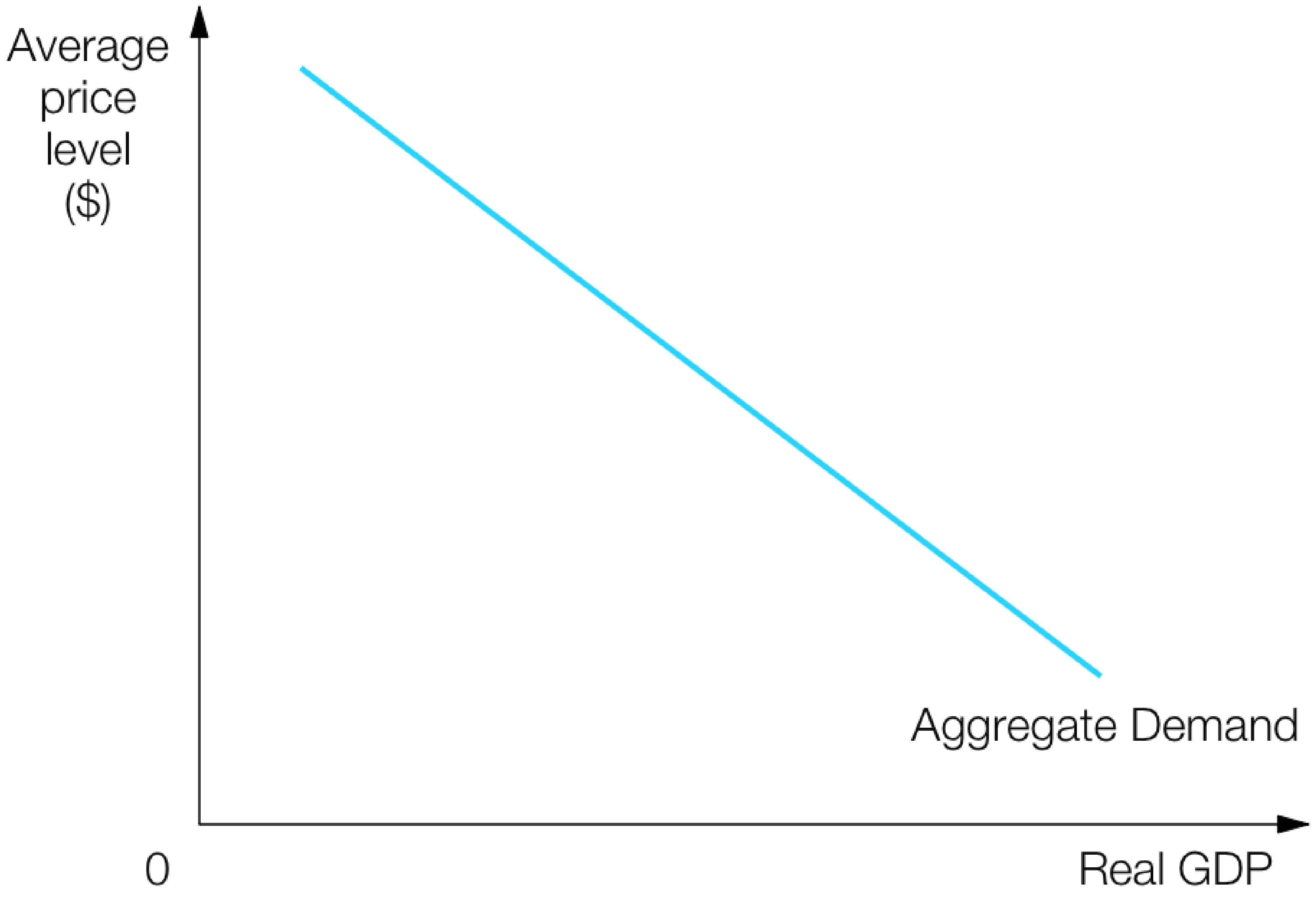
Determinants of AD components

Shifts of the AD curve caused by changes in determinants

Aggregate demand

Aggregate demand is the value of **all** goods and services demanded in the economy.

The **Aggregate Demand** curve shows the real national output that is purchased at each price level, per time period.



The aggregate demand curve

Real Output = Real GDP = National Income = Y

The components of Aggregate Demand

$AD = C + I + G + (X - M)$

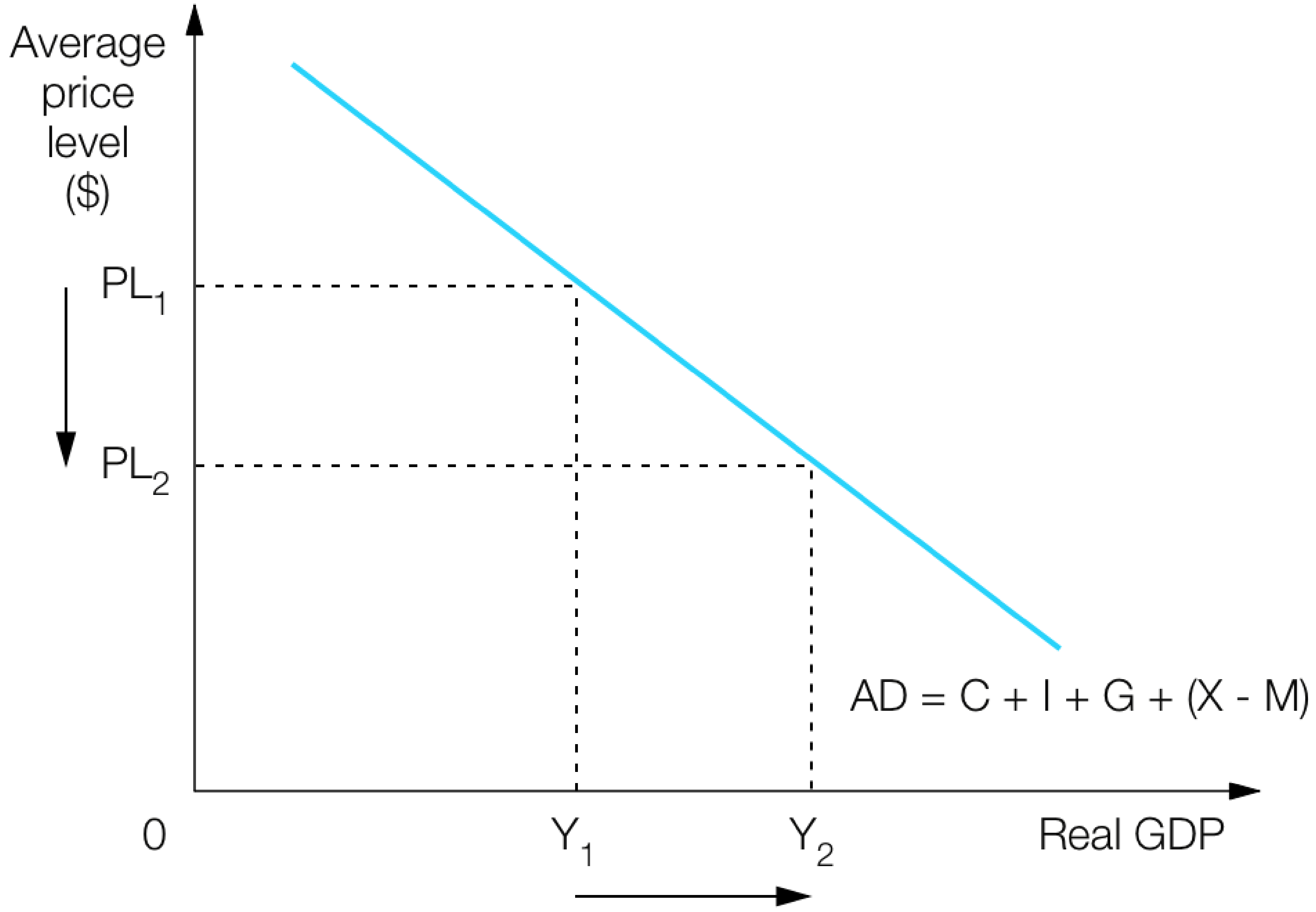
Consumption (C) is the total spending on domestic goods and services.

Investment (I) is the expenditure of all firms in the economy to increase their capital stock (goods made by people that are used to produce other goods and services e.g., factories, machines, offices, and computers) and their production capacity.

Government (G) spending is the total expenditure on goods and services by the public sector e.g., health, education, welfare, transport, security.

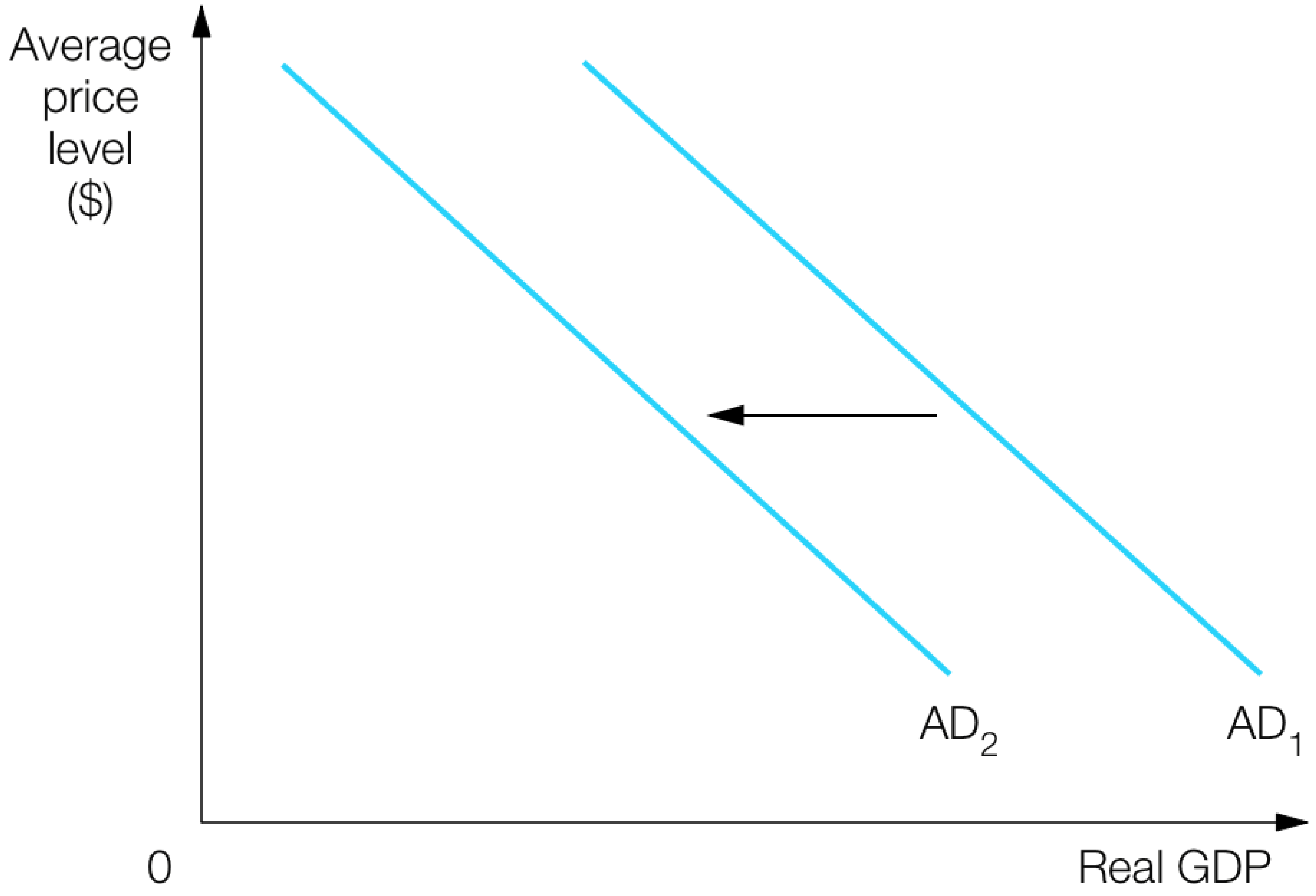
Net exports (X - M) – measures the difference between the value of the country's exports and its imports in the time period.

The components of Aggregate Demand

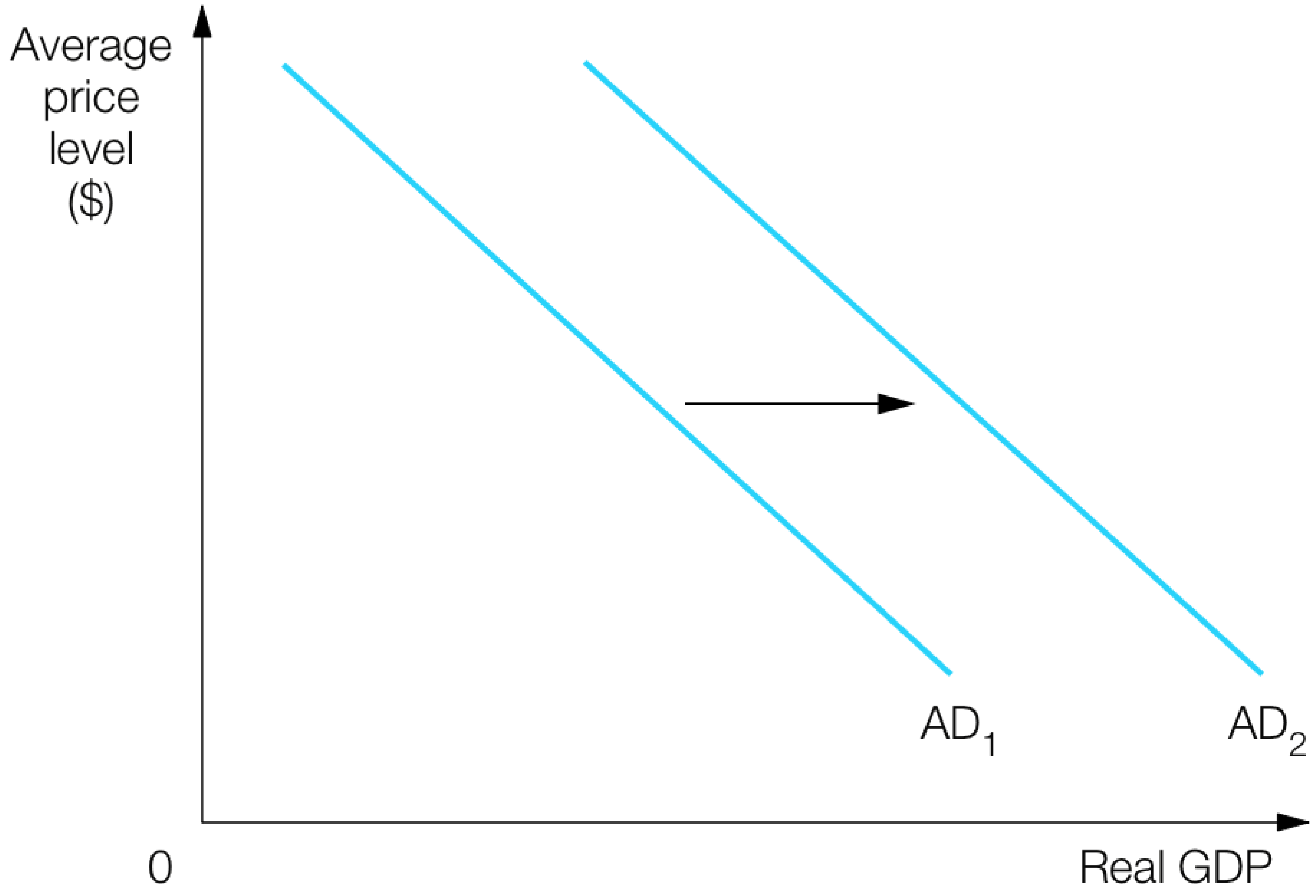


The aggregate demand curve

A shift in aggregate demand



A leftward shift in aggregate demand



A rightward shift in aggregate demand

What causes changes in consumption?

Income taxes

Interest rates

Consumer confidence

Wealth

Expectations of the future price level

Levels of household indebtedness (households with debts)

Note – consumption is the largest component of AD in most countries.

What causes changes in investment?

Interest rates

Business taxes e.g., corporation tax

Technology

Business confidence

Level of corporate indebtedness

What causes changes in government spending?

Political priorities

-In a democracy, an increase in spending on education and healthcare would be popular with the electorate and may win votes.

-During a recession, the government may increase welfare payments as unemployment rises.

Economic priorities

-Subsidies for a particular industry.

-Austerity measures may be needed to reduce a government budget deficit following a period of significant government spending.

What causes changes in net exports?

Exports - goods or services that are brought by foreigners

Imports

The economic health of trading partners (income of trading partners)

Exchange rates

Trade policies

Note – we will learn about international trade in more detail in the unit titled Global Economy.

Aggregate demand

Paper 1 style questions

Explain how aggregate demand is likely to be affected by an increase in the wealth of consumers and an decrease in income taxes [10 marks]

Explain how changes in two determinants of consumption could lead to an increase in real gross domestic product (GDP) [10 marks]

Explain why an increase in interest rates might lead to a reduction in aggregate demand [10 marks]

Components of Aggregate demand

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Changes in consumption (C)

– consumer confidence

Components of Aggregate demand

THE DAILY AUS

Reserve Bank cuts interest rates for the first time since 2020

February 18, 2025 • Harry Sekulich • Economics •

The Reserve Bank has cut interest rates for the first time since 2020, saying inflation has reduced substantially from its peak in 2022.

Changes in consumption (I)

– interest rates

Components of Aggregate demand

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Changes in investment (I)

– interest rates

Components of Aggregate demand

Economy / China Economy

China’s digitalisation push seeks ‘digital energy’ to spark vital tech, economic growth in Greater Bay Area

- China’s southern province of Guangdong pledged to build a so-called Digital Bay Area in a detailed 15-page blueprint
- It is hoped the plan would become an economic growth point, and ‘digital energy’ would be a driving force for high-quality economic and social development

Changes in investment (I)
– technological changes

Components of Aggregate demand

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Singapore economy continues to be hit by slumping exports

Changes in Net Exports (X-M)
– exports

Components of Aggregate demand

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Changes in investment (I)
– business confidence