2.2.1 The characteristics of AD

a) Components of AD: C+I+G+(X-M)
b) The relative importance of the components of AD
c) The AD curve
d) The distinction between a movement along, and a shift of, the AD curve

- Aggregate demand is the total amount of expenditure on goods and services or total demand at any price in an economy therefore aggregate demand comprises of all the components that contribute to spending/ demand in an economy
- AD= Consumption (C) + Investment (I) + Government spending (G) + Net trade (exports (X)- imports (M))
- An increase in AD increases economic growth since GDP can be measured using an economy's total expenditure
- Consumption is the largest part and is normally about 65% of spending
- AD curve features:
    - Can be a straight or a curved line
    - Total expenditure by the economy remains much the same along the AD curve and this is called the real balance effect. This means that when prices fall, people spend approximately the same amount but they buy a larger amount of items
    - Higher prices can't be avoided by buying cheaper alternatives so total area under the AD curve remains approximately the same whatever the price level
    - The price level is the average level of price in an economy likely to be the CPI
- Reasons why the curve is downward sloping
    - Wealth effect: if prices fall, people can purchase more goods and services (increased purchasing power)
    - Trade effect: if prices are low, exports are more competitive – domestic consumers import less as prices are already low
    - The demand for imports will increase- if prices haven't risen abroad, imports will become cheaper in comparison
- Movements along a demand curve occur when there is a change in price level caused by factors that are not related to aggregate demand i.e. aggregate supply
- AD shifts when any one of the components C+I+G+(X-M) changes, independent of the price level; the size of change depends on the multiplier
- An injection causes a right shift and a withdrawal a left shift
- An outward shift of the AD curve means that at a given price level, more can be produced- but also, a given amount of output will have a higher price level
- An inward shift of the AD curve means that at a given price level, less can be produced- but, a given amount of output will have a lower price level
- Labour is derived demand- an increase in AD means output increases, so the demand for labour increases. More jobs are created so that the extra output can be produced, and there will be an increase in employment levels
- If inflation occurs there is a fall in International Competitiveness

- When aggregate demand shifts there will be changes in the price level and equilibrium real output
- If aggregate demand increases, we expect the average level of prices to prices to rise (inflation) and real input to increase (economic growth)
- If aggregate demand decreases we expect the average level of prices to fall (deflation) and real output to decrease (slowdown or recession)