

Inflation (2%)

Inflation: rise in average prices

and wages are not rising → lower disposable incomes → living standards
 raise prices more ← ask for wages ↑
 sack workers → UE → disposable incomes
 living standards

Deflation: fall in av prices

people delay spending → AD ↓ (C↓)
 people lose jobs ← deflation. ←
 recession → low confidence/uncertainty

Unemployment

Cyclical: low AD in economy → demand side policy

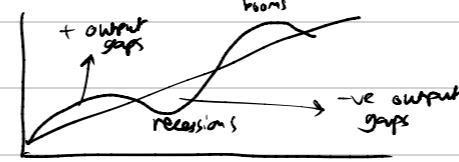
Structural: when an industry declines, → supply-side policies
 no transferrable skills

Economic growth

increase in real GDP → total value

SP: caused by an increase in AD] fiscal monetary

LP: caused by an increase in LRAS (productive potential)] supply side policies



+ : when actual growth > trend growth] inflation

- : when trend growth > actual growth] recession

Fiscal policy

use of G & T to influence AD

IMPORTANT during a recession → low AD.

inflation, budget deficit → national debt
 lower living standards → austerity → spending in future
 multiplier → small effect.
 GROWING OUT EFFECT.

Monetary policy

use of IR to influence AD

bank rates adjusted every month.
 Quantitative Easing → create fake money
 lower IR ← money supply

exchange rates not below 0%
 deflation: -3%
 interest rates are 1%] real interest rates would be 1 - -3 = 4%

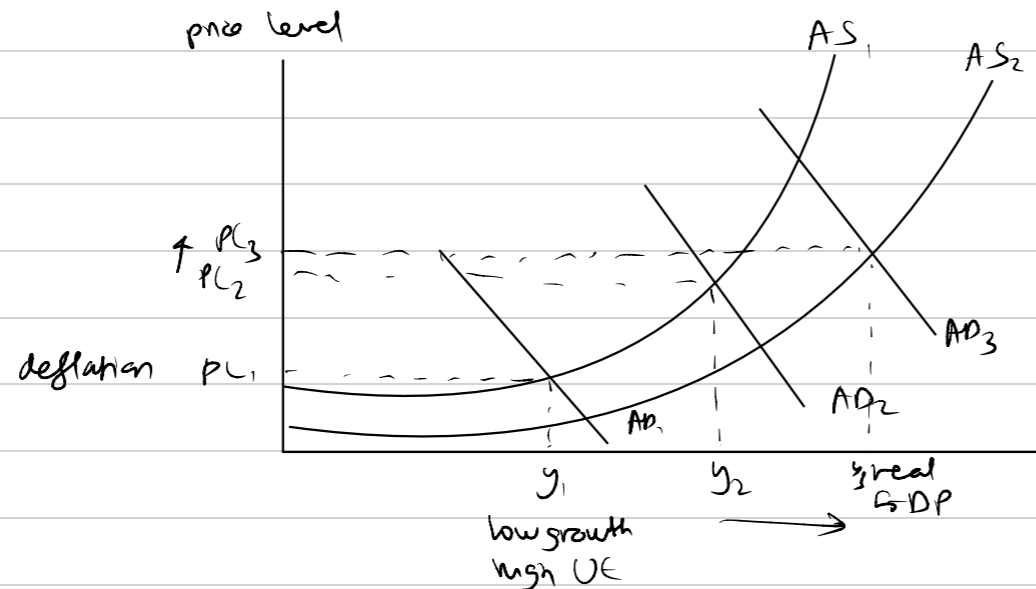
Supply-side policy

use of policies to influence LRAS.

spend on education infrastructure] PRODUCTION CAPACITY
 lower benefits] INCENTIVES
 lower corporation tax
 lower income tax

very good if there is inflation / + output gap

HS2 £100bn, over 10 years
 → opportunity cost
 → time lag.



AD: total planned spending in economy

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

exchange rates inflation.

interest rates disposable income
 Confidence

interest rates confidence
 state of economy

multiplier: $k = \frac{\Delta Y}{\Delta G}$ roadworks → restaurant
 coffee → dessert.

AS

SRAS: costs of production
 raw material prices
 wages
 exchange rates

LRAS: incentives technology

Accelerator theory: firms investment ↑ when economic growth is high

$$k = \frac{1}{1 - MPC}$$

→ marginal propensity to consume