Aggregate Demand & Aggregate Supply

Recall:

1) Equilibrium output

(Q*) is determined by tastes, technology and population

2) GDP or total spending is determined by money supply & demand:

\[ Y = \frac{M}{K} \]

where M is money supply and K is demand for money

Total spending is often referred to as “aggregate demand”-AD
**Comparative Static**

Consider the effects of change in money supply

- Increase in the money supply

![Graph showing comparative static analysis with LRAS and AD=M/K curves.](image)
Decrease in the money supply

Effect of M decreasing leads to “too little money” relative to other things (cars, houses…).

Changes in Demand for Money

i.e. changes in K, the desired cash balance ratio