purchase by people of new homes

NON-RESIDENTIAL INVESTMENT - purchase by firms of new plants or machinery

Inventory investment

Difference between goods produced and goods sold in a given year

$$\text{Total demand} = C + I + G + X - M$$

COMSUMPTION

Depends mainly on disposable income (Y_d)

$C = C(Y_d)$

$C(Y_d)$ - consumption function (C is function of Y_d)

Behavioural equation

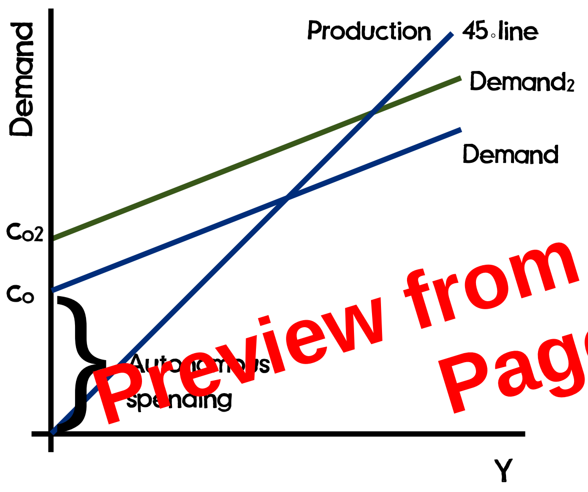
$$C = c_o + c_1 Y_d$$

c_o - what people would consume if disposable income were zero

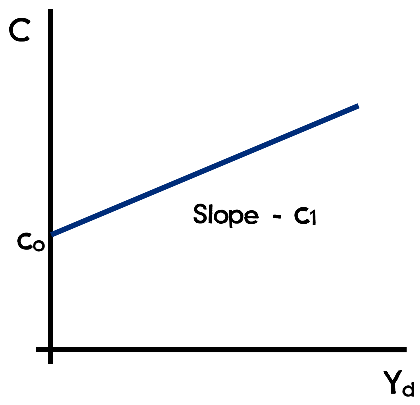
Positive as can DISSAVE (sell assets or borrow)

$c_1 Y_d$ - PROPENSITY TO CONSUME - effect of one additional unit of disposable income

Positive but less than one (rest is saved)



EQUILIBRIUM IN GOOD MARKET



Shifts to Demand₂ when autonomous income rises

An increase of $1bn in c_o will lead to a larger increase in income and demand

IS RELATIONSHIP

IS - investments equals savings (Keynes, 1936), what firms invest must be equal to public and private spending