Michaela smart
Economics

6/12/14

Discuss the extent to which an increase in aggregate demand may affect output, unemployment and inflation

Aggregate demand is the total demand for a country's goods and services ar a given level and in a given time period. There are several components of AD: consumer expenditure, investment, government spending, exports and imports. A change in any of these will affect AD. Unemployment is the number of people in the work force who willing, able and actively seeking work but do not have a job. Real GDP is the country's output measured in constant pries and so adjusted for inflation. Inflation is a sustained rise in the price level.

An increase in AD to AD1 would increase national output and decrease unemployment. The output gap would be decreased as more factors of production would be employed, including labour. Thus increasing the number of people in work and thus decreasing unemployment. This is because more people would be required to produce the increased number of demanded goods and services demanded. This increase in AD would not however affect inflation, this is because at AD the economy was operating at well under full employment; in other words the output gap was substantial. Therefore when AD increase to AD1 there were unemployed factors of production (land, labour, capital and enterprise) to utilize without having to offer, for example a higher level of pay to attack workers from other jobs or attack immigrants hence achieving economic growth as the GDP will increase without inflation (P* to P1 marks no increase in price level however Y* has increased to Y1). If national income increases this shows that output has increased as GDP is equal to income, output and expenditure. Therefore if national income increases then output has too. Output has increased because more people will be demanding more goods and services so more need to be produced and more are sold. Therefore an increase in AD to AD1 would decrease unemployment, have no effect on inflation and increase output and the economy would be operating at full or near to full employment (the output gap would be negligible)

If the economy is operating at full employment and aggregate increases (AD1 to AD2), for example if consumer expenditure increases due to a good economic forecast increasing consumer confidence, then this will increase the