KEYNESIAN MODEL

ASSUMPTIONS

KEY

(1) $\bar{P}$ (SHORT RUN)

(2) SUPPLY ADJUSTS TO MEET DEMAND

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(3) $T = T_0 + t_1 Y$

So set $t_1 = 0$: $T = T_0$

(4) $M = M_0 + M_1 Y$

So set $M_1 = 0$: $M = M_0$

slope of AE = mpc

$$Y = \underbrace{C + I + G + NX}$$

AGG. DEMAND / AGG. EXPENDITURES

CONSUMPTION FUNCTION

$$C = C_0 + C_1(Y-T) = 475 + \tfrac{3}{4}(Y-T)$$

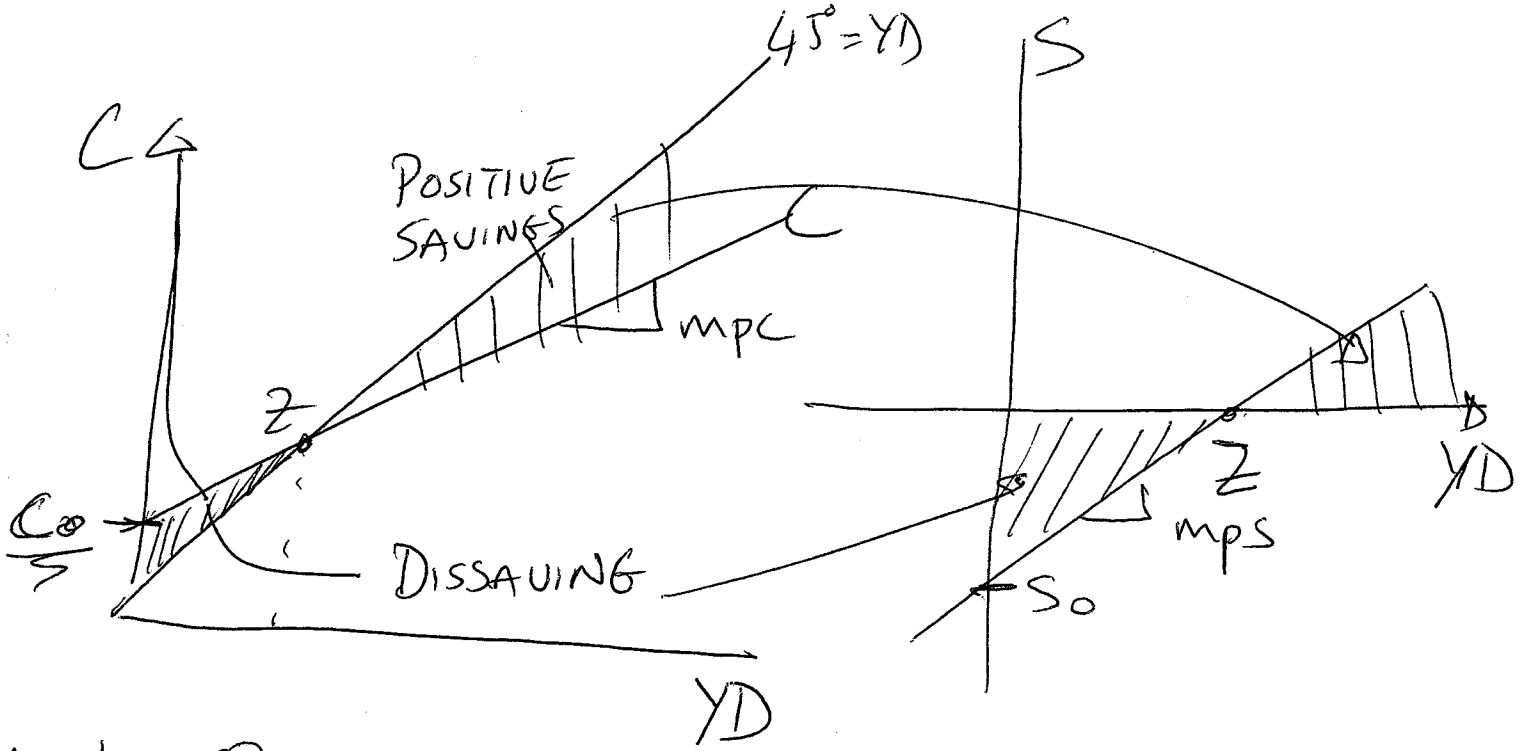
C_0: Autonomous Consumption

C_1: mpc; $0 \le C_1 \le 1$

$$S_p = S_0 + S_1(Y-T) = -475 + \tfrac{1}{4}(Y-T)$$

S_0: Autonomous savings

S_1: mps; $0 \le S_1 \le 1$



Note: (1) $0 \le C_1 \le 1$; $0 \le S_1 \le 1$

(2) $C_1 + S_1 = 1$

(3) $C_0 + S_0 = 0$.

Derive The AE Schedule

$C = 475 + 3/4(Y - T)$

$I = 150$

$G = 250$; $T = 100$

$X = 150$; $M = 50$

$AE = C + I + G + NX$

$= 475 + 3/4(Y - 100) + 150 + 250 + 150 - 50$

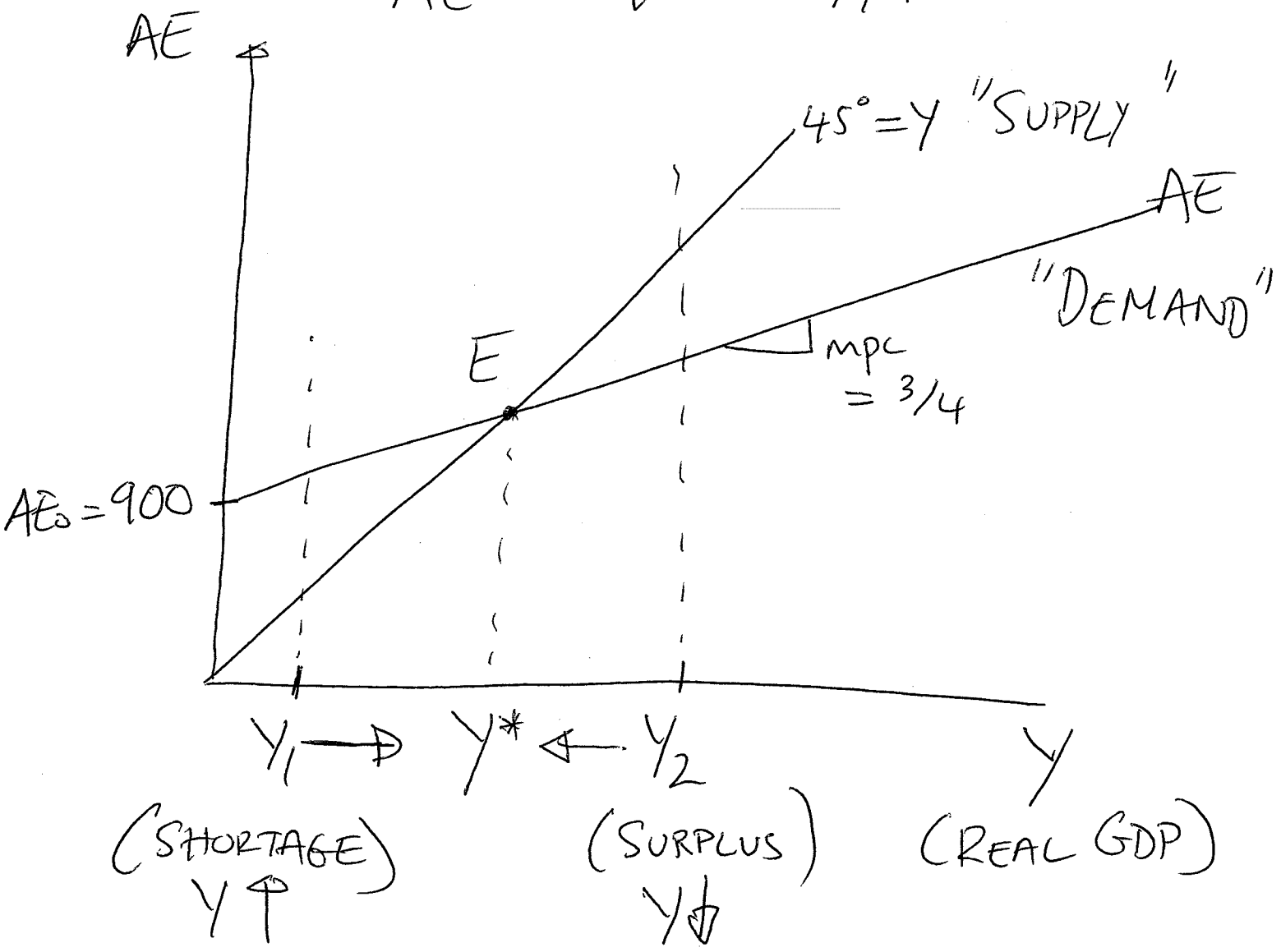
$$\boxed{AE = 900 + 3/4\,Y}$$

$= AE_0 + (\text{slope of the AE}) \times Y$

Autonomous Expenditures

Induced Expenditures

$$AE = 900 + 3/4\,Y$$



At E: No unplanned changes in inventory.

At Y_1: Unplanned drop in inventory.

At Y_2: " increase in inventory