Unit III: Cyclical Instability

Why are markets unstable & what should be done to manage them?
Ch. 9: Aggregate Demand p. 166-177

Name: ______________________

Keynes’s Key questions:

Components of Aggregate Demand (spending sectors in GDP)

GDP=_________+_________+_________+(_________ - __________)

Components of Consumption

- _____ % of GDP
- Increases in income → ________ spending at every price level
- Disposable Income or \( Y_D \) (define)
  \( Y_D = \underline{_________} + \underline{_________} \)
- Average Propensity to Consume or APC (define)
  \( APC = \underline{____________} \)
- APS = 1 - APC
- Marginal Propensity to Consumer or MPC (define)
  \( MPC = \underline{____________} \)
- MPS = 1 - MPC

Consumption Function

- Consumption results from 2 things:
  o Autonomous Consumption
  o Income Directed Consumption
- Autonomous Consumption (define)
  o Determinants
  -
  -
  -
- Consumption Function
  o \( C = a + bY_d \)
    - Where \( C = \underline{_________} \)
    - \( a = \underline{_________} \)
    - \( b = \underline{_________} \)
    - \( Y_d = \underline{_________} \)
  o Key Insights:
    -
    -
Describe & Depict the Consumption Function:
\[ C = a + bY_d \]

- Dissaving:
- Saving:
- 45 Degree Line:
- Slope of Consumption Function:

- Draw a third line on the chart above \((C_2)\) to demonstrate a change in “a”
  - What impact does a change in “a” have?
- Draw a fourth line on the chart above \((C_3)\) to demonstrate a change in “b”
  - What impact does a change in “a” have?

Cyclical Instability in the Consumption Function

- If consumer incomes change autonomous consumption changes, then the ________________ will shift, causing macro instability (business cycles)
- Changes in autonomous consumption will result from
  - 
  - 
  - 
  - 
- Depict an increase in personal income taxes impacting both the consumption function & the macro model:
  
  Consumption Function
  
  Macro Model (AD & AS)