OCR Economics A-level

Macroeconomics

Topic 1 – Aggregate Demand and Aggregate Supply

Definitions and Concepts

1.1 – Circular flow of income

Circular flow of income - A model of the economy which shows the flow of goods and services, the factors of production and money around the economy.

Injections - Spending power entering the circular flow of income resulting from investment, government spending and exports.

Leakages - Spending power leaving the circular flow of income resulting from savings, taxation and imports.

Macroeconomic equilibrium - Where the rate of withdrawals equals the rate of injections.

Monetary flows - The flow of money, for example from taxes or for consumption.

Physical flows - The flow of a good or service.

1.2 – Aggregate demand

Aggregate demand (AD) - The total level of demand in an economy at any given price level at a moment in time.

Consumption - Consumer spending on goods and services.

Exports - Goods and services sold to foreign countries that provide an inflow of money.

Imports - Goods and services bought from foreign countries that lead to an outflow of money.

Investment - Spending by businesses on capital goods, which leads to the creation of real goods.

Government expenditure - Spending by the government for the provision of goods and services.

Net exports - Exports minus imports.

1.3 – Aggregate supply

Aggregate supply (AS) - The total amount of output in the economy at any given price level at a moment in time.

Long run - When all factors of production are variable.

Long run aggregate supply - The total output an economy can produce when operating at full output.

Short run - When at least one factor of production is fixed.

Short run aggregate supply (SRAS) - Aggregate supply when at least one factor of production is fixed.

1.5 – The multiplier and the accelerator

Accelerator theory - A change in consumption will cause a larger percentage change in investment; high consumption leads to high investment.

Average propensity to consume - The percentage of income spent on goods and services, expressed by: total consumption / total income.

Average propensity to save - The percentage of income that is saved, expressed by: total savings / total income.

Marginal propensity to consume (MPC) - The proportion of an increase in income spent on consumption, expressed by: change in consumption / change in income.

Marginal propensity to save (MPS) - The proportion of an increase in income that is saved, expressed by: change in money saved / change in income.

Marginal propensity to withdraw (MPW) - The proportion of an increase in income that is withdrawn from the circular flow.

Multiplier - An increase in an injection will lead to an even greater increase of national income. Expressed by:

(1-MPC)   MPW
1   =   1

Negative output gap - When GDP is lower than predicted; the economy is producing below full output.

Output gap - The difference between the long term trend rate of growth and actual growth.

Positive output gap - When GDP is higher than predicted; the economy is producing above full output.