

## 2.2 Aggregate demand

### The characteristics of Aggregate Demand

- i. What is Aggregate Demand?
- ii. What are 4 components of AD?
- iii. What % of AD is comprised of each component?
- iv. Explain why a 1% increase in consumption would have a bigger impact on the economy than a 1% increase in investment
- v. Explain 3 reasons why the AD curve is downward sloping
- vi. Illustrate a contraction of AD
- vii. What could have caused such a contraction?
- viii. Illustrate an expansion of AD
- ix. What could have caused such an expansion?

### Consumption

- i. Define Consumption
- ii. Define Disposable Income
- iii. Explain the relationship between Disposable Income and Consumption
- iv. Explain the relationship between Savings and Consumption
- v. How is the (Household) Savings Ratio calculated?
- vi. What is the current Household Savings Ratio?
- vii. Give 3 reasons why interest rates and consumption are inversely related
- viii. Explain the relationship between confidence and consumption
- ix. Define Wealth
- x. Explain how changes in wealth may change consumption

### Investment

- i. Define Investment
- ii. Explain the difference between net and gross investment
- iii. Explain the difference between capital depletion and capital depreciation
- iv. Explain the two ways in which investment may be funded
- v. Define Interest Rates
- vi. Explain the relationship between interest rates and level of investment
- vii. Explain the relationship between economic growth and level of investment
- viii. Explain the relationship between business expectations/confidence and level of investment
- ix. Explain what is meant by 'animal spirits'
- x. Explain the relationship between demand for exports and level of investment
- xi. Explain the relationship between the access to credit and the level of investment
- xii. Explain how the Government might encourage investment
- xiii. Explain how onerous regulation may discourage investment

## Government Spending

- i. Explain what is meant by Government Expenditure
- ii. Define Transfer Payments
- iii. Explain why Transfer Payments are not included in the G component of AD
- iv. Explain why Government Spending is typically counter-cyclical to the trade cycle
- v. Explain the difference between expansionary and contractionary fiscal policy
- vi. Explain which of these two would likely result in higher Government Spending
- vii. Explain why this is not necessarily **always** the case

## Trade Balance

- i. Explain the meaning of Trade Balance
- ii. Explain the difference between Exports and Net Exports
- iii. Explain the effect of an increase in Imports on AD
- iv. Explain the impact of an increase in real incomes on the trade balance
- v. Explain the impact of depreciation of the £ on the trade balance
- vi. Explain which would have the largest effect on the trade balance: a depreciation of the £ against the € or a depreciation of the £ against the Peruvian Sol
- vii. Explain whether a depreciation of the £ would have a bigger effect if the demand for UK elastic is price elastic or price inelastic
- viii. Explain the effect of a recession in a major trading partner on the UK's trade balance
- ix. Explain the effect of increasing protectionism on the UK's trade balance
- x. Explain what 'non price factors' might affect the UK's trade balance

## Essays:

- 1) Evaluate the view that interest rates are the main determinant of investment in the UK
- 2) "The rate of change of average earnings is the only significant determinant of the level of consumption in the economy." Assess the validity of this statement, making reference to data
- 3) Evaluate the factors which could influence the importance of the relative components of AD