CONCEPT: MONETARY POLICY AND AGGREGATE DEMAND

● Recall that ***Aggregate Demand*** is the total level of ______________ in the economy (C + I + G + NX)

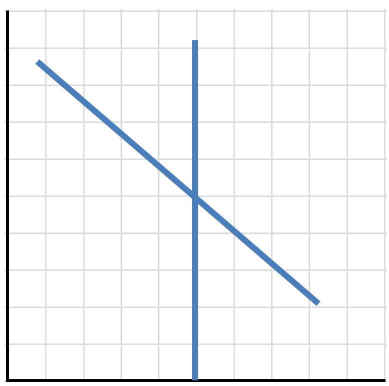
- □ The interest rate affects aggregate demand because it affects consumption, investment, and net exports
  - > *Consumption*: Financing purchases through borrowing happens more often at ________ interest rates
  - > *Investment*: More projects become profitable at _________ interest rates
  - > *Net Exports*: US interest rates fall →Foreigners demand less dollars → Dollar value ________ → Net Exports _____________ (US imports less with weaker dollar)
  - > Note that the interest rate is the y-axis on the ________________ graph

EXAMPLE: The Fed intends to stimulate the economy by lowering interest rates.

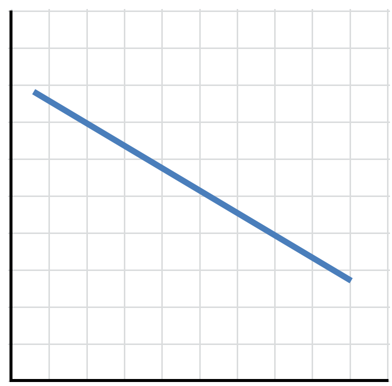
a) What open market operation should the Fed use to lower interest rates?

b) What affect will the lower interest rate have on aggregate demand?

Money Market



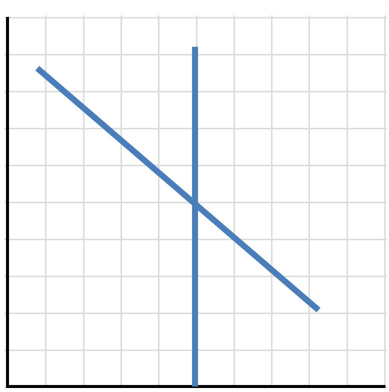
Aggregate Demand



- □ The relationship between aggregate demand and the money market is also affected by the price level
  - > Note that the price level is the y-axis on the ________________ graph

EXAMPLE: The general price level increases in the United States. What affect will this have on the following graphs?

Money Market



Aggregate Demand