

The background is a dark teal color with various financial symbols and numbers scattered across it. Symbols include the dollar sign (\$), yen sign (¥), pound sign (£), and euro sign (€). Numbers are in various sizes and colors (yellow and teal). There are also upward and downward arrows. The overall theme is economics and finance.

Classical Theory of Aggregate Demand

Introduction

The quantity theory is the *implicit* theory of the aggregate demand for output within the classical system.



An Example

Let the value of k be one-fourth so that velocity of money is -----



Continued

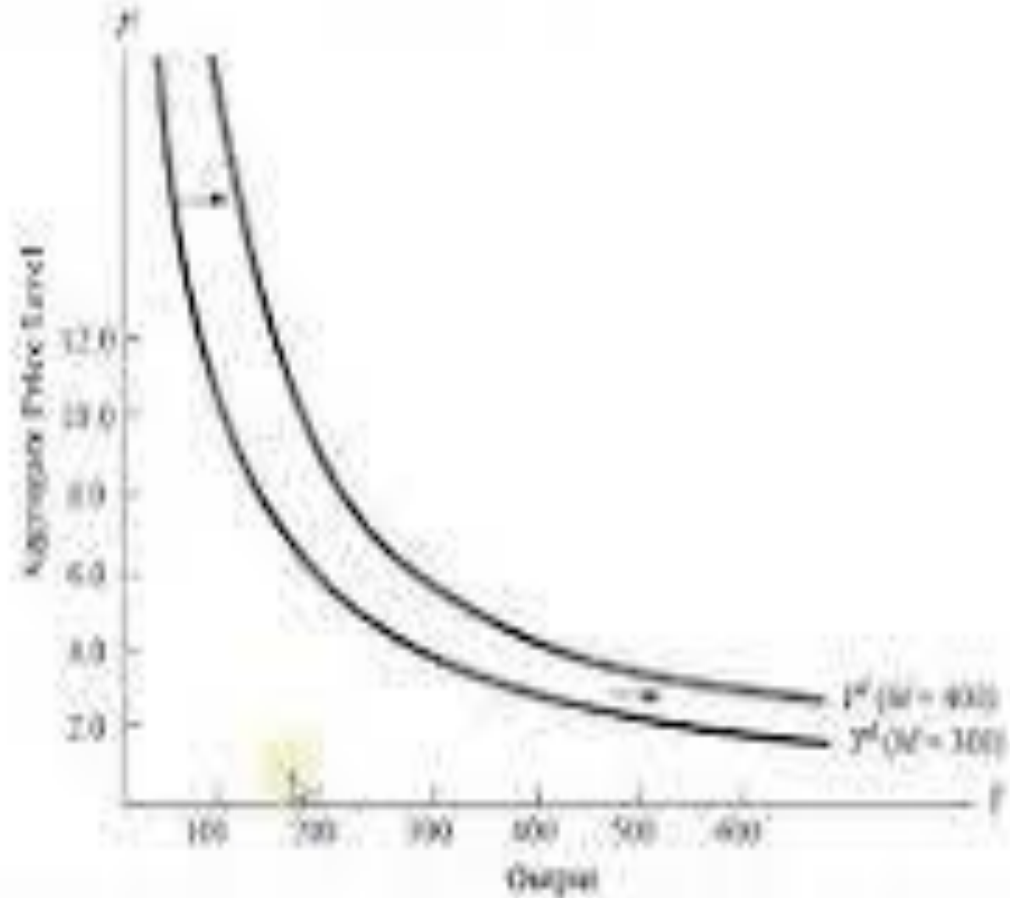
The classical aggregate demand curve plots combinations of the price level (P) and output (Y) consistent with the quantity theory equation $PY = MV$, for a given money supply (M) and fixed velocity

With $M = 300$ and velocity assumed to be 4, several points of P and Y give the aggregate demand curve



Continued

FIGURE 4-1 Classical Aggregate Demand Curve



The classical aggregate demand curve plots combinations of the price level (P) and output (Y) consistent with the quantity theory equation $PY = MV$ for a given velocity (V) and fixed money supply (M). The aggregate demand curve is downward sloping because as the price level falls, the quantity of output demanded increases.

Continued

Now consider a higher value of the money supply of, for example, 400 units. k equal to one-fourth ($V = 4$), $P * Y$ must now equal 1,600. The schedule $Yd (M = 400)$ corresponding to a value of M equal to 400 lies above and to the right of the $Yd (M = 300)$ schedule and shows all $P * Y$ combinations of 1,600.

An increase in the money supply shifts the aggregate demand curve to the right.

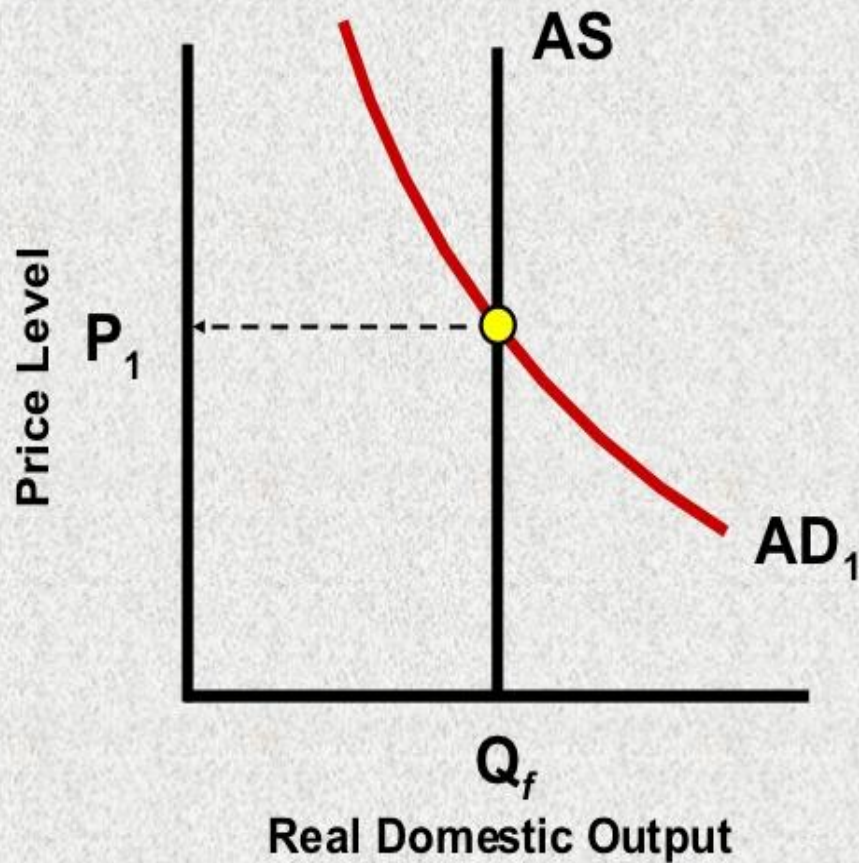
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For a given supply of money, we derive a downward-sloping aggregate demand curve that can be put together with the vertical aggregate supply curve to illustrate the determination of price and output in the classical model



Continued

Classical Theory



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Successive increases in the money supply, from $M1$ to $M2$ and then to $M3$, shift the aggregate demand curve to the right, from $Yd(M1)$ to $Yd(M2)$ to $Yd(M3)$.

The price level rises from $P1$ to $P2$ to $P3$. Output, which is supply-determined, is unchanged ($Y1 = Y2 = Y3$).



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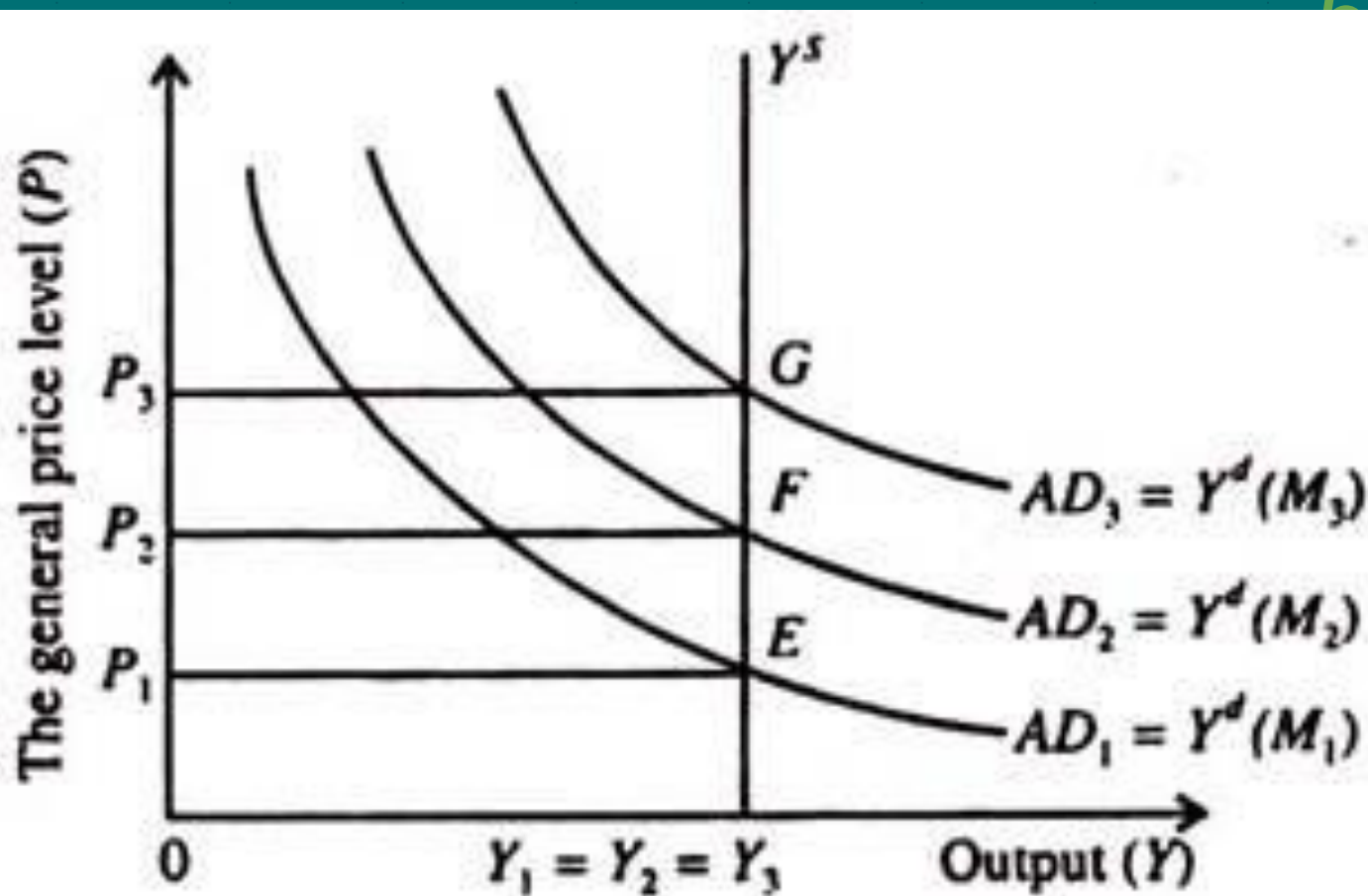


Fig. 3.10 AS and AD in the Classical System

THANK YOU

