PENANG SANGAM HIGH SCHOOL
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LESSON NOTES

Subject: Economics **Year/Level:** 13C

Week 8

Strand	3	Macroeconomics
Sub Strand	3.2.1	Income & Expenditure analysis
Content Learning Outcome	Analyse the income and expenditure analysis	

Greetings to all…

Let's first discuss the activity on savings and interest rate. You can mark and do the correction for your answers.

Solutions

1. Paradox of thrift is a Latin phrase that states as the society tries to save more, it essentially leads to a fall in aggregate demand and hence in economic growth.
2. An increase in interest rate will increase the cost of borrowing as such investment by firms will decrease.
3. A decrease in interest rate will discourage individuals to save as the reward of savings will be less as such savings by individual will decrease.

Now let us look at the next sub-strand on Income and expenditure Analysis.

(Copy the Achievement Indicators in your note book)

Achievement Indicators:

1. Explain the Keynesian Model of Determining income.
2. Define AD and AS
3. Identify and explain components of AD.
4. Describe and graphically illustrate consumption and savings function.
5. Calculate MPC and MPS.
6. Construct income and expenditure model to determine the equilibrium level of GDP and spending.
7. Graphically distinguish between inflationary and deflationary gap and identify policies to eliminate the gaps.
8. Define and illustrate business cycle.

<u>Lesson Notes</u> (Copy in your Note book)

<u>THE KEYNESIAN MODEL OF INCOME DETERMINATION</u>

Keynes believed that there are two major factors that **determine** the national **income:**

1. Aggregate Supply (AS)
2. Aggregate Demand (AD) of goods and services.

In addition, he believed that the equilibrium level of national **income** can be estimated when AD=AS.

This model assumes that the aggregate supply curve is perfectly elastic up to the full employment level of output after which it becomes perfectly inelastic. Hence, price level, until the full employment level, will be determined solely by the height of the supply curve. More focus is on the determination of equilibrium level of income, which is determined solely by the aggregate demand.

Keynes assumes the aggregate supply function to be stable, he concentrates his entire attention upon the aggregate demand function to fight depression and unemployment. Thus employment depends on aggregate demand which in turn is determined by consumption demand and investment demand.

Keynes stated employment can be increased by increasing consumption and/or investment. Consumption depends on income C(Y) and when income rises, consumption also rises but not as much as income. In other words, as income rises, saving rises.

Consumption can be increased by raising the propensity to consume in order to increase income and employment. However, propensity to consume depends upon the people tastes, habits, wants and the social structure which determine income distribution. All these elements remain constant during the short-run.
Therefore, the propensity to consume is stable. Employment thus depends on investment and it varies in the same direction as the volume of investment.
(We will continue with the components in the next lesson)

Stay Safe…..