



3055 BA SANGAM COLLEGE

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LESSON NOTES

WEEK 11

Subject: Economics

Year / Level: 13

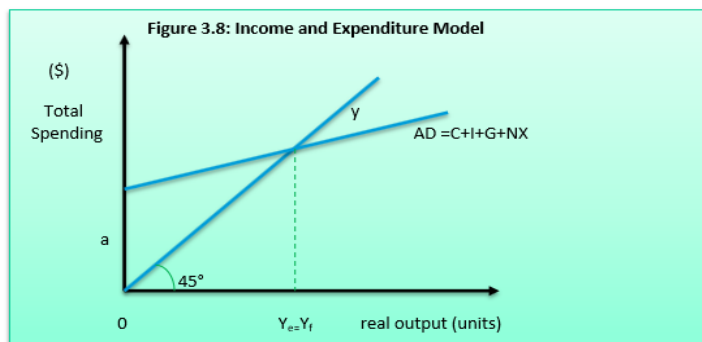
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|--------------------------|--|
| Strand | 3 - Macroeconomics |
| Sub Strand | Income and expenditure analysis. |
| Content Learning Outcome | Analyse the income and expenditure analysis. |

INCOME AND EXPENDITURE AND MULTIPLIER ANALYSIS

Y in the graph below shows Potential GDP. It refers to the expected level of output when all the resources in the economy are fully utilised.

AD in the graph shows Actual GDP or current level of output in the economy.

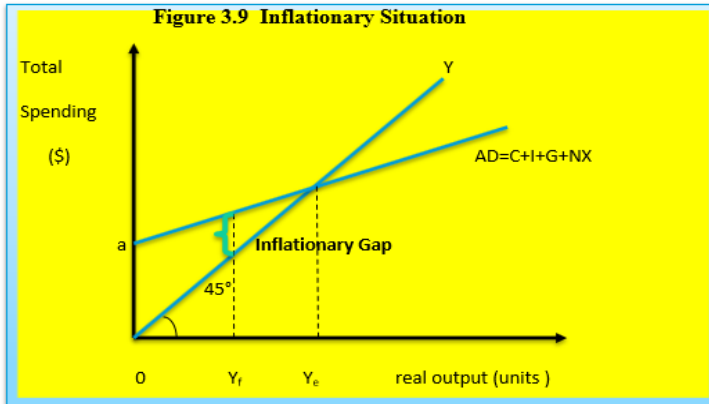


Inflationary or Deflationary Gap

When an economy is not producing at its full employment level it is said to be in disequilibrium position. That is either there inflationary or a recessionary situation in the economy.

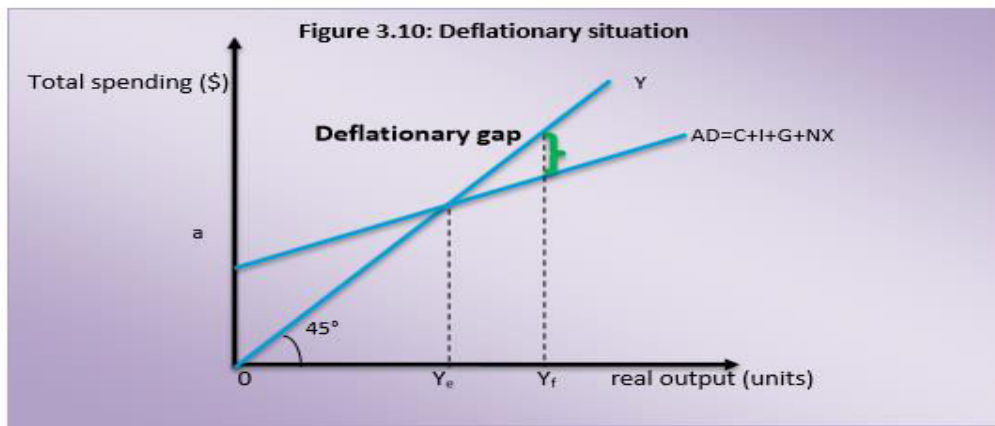
An inflationary situation

- ❖ Arises when the full potential GDP falls short of equilibrium or actual GDP. It is a situation where AD is higher than the Y line.
- ❖ In other words actual GDP is more than the potential GDP
- ❖ Thus Overutilization of resources
- ❖ Occurs when an economy is operating above its full capacity
- ❖ Pressure of demand on existing resources, as a result input price will rise such as wages. Hence cost of production increases leading to increase in the final prices of goods and services.



Recessionary Situation/ Deflationary Situation

- ❖ This arises when full potential GDP (Y_f) lies beyond the actual GDP (Y_e). In other words aggregate demand falls short of aggregate supply at full employment level of income and output.
- ❖ The actual level of output is less than the potential GDP.
- ❖ Thus underutilisation of resources
- ❖ As a result input price will fall such as wages. Hence cost of production decreases leading to a fall in the final prices of goods and services.



Activity

ESSAY

In Keynesian analysis, internal balance usually does not exist and the equilibrium level of GDP is either below or above the full employment level.

Evaluate the above statement with reference to:

- The definition of both the inflationary and deflationary gaps and another name for the deflationary gap. (3marks)
- The type, direction and nature of the fiscal policy require to eliminate a deflationary gap (3marks)
- The type, direction and nature of the fiscal policy needed to eradicate an inflationary gap (3marks)