

Aggregate Demand in the USA:

Instructions:

This exercise assumes that students know what AD is and have derived a downward sloping AD curve. When introducing AD, it can be useful to go back to the circular flow and show that AD is basically household expenditure (C) plus the injections (I+G+X) minus any of this demand that actually goes abroad. Hence $AD = C + I + G + X - M$.

After that it's fairly self-explanatory. Get the students to read the story on the US recovery and then work in pairs/small groups to complete the task. It might be worth blowing the grids up onto A3 if small groups are doing it.

Read the article and answer the questions below



Whether or not the US economy starts to improve in the second half of 2011 depends on four factors: Will consumers spend more? Will business investment pick up? Will the government continue with its austerity? And will U.S. exporters manage to sell more goods and services to the world?

CONSUMPTION

In past recoveries, increases in consumer spending were often the engine of growth.

Today's consumers, however, are deep in debt (which has been heightened by years of cheap credit, a housing bust and the fear of prolonged economic decline) and they can't drive the economy as they once did.

The job market is not helping things. Despite some government bailouts, most estimates have unemployment across the country declining by a further % point by the end of the year. The projected loss of sales for many businesses threatens people's job security whilst the [public] debt crisis in the U.S. and across many countries in Europe could further stress consumer confidence.

INVESTMENT

Business investment in new equipment and IT software is a rare bright spot for the US economy – it has grown at a 7.2% rate in the first half of the year.

However, in an uncertain economy, companies have been holding off with large capital investments such as new buildings and factories until orders accumulate. Due to the public debt problem and concern over a possible downgrade of U.S. credit rating, businesses are also delaying their major purchases to see which areas the government is going to make cuts from.

GOVERNMENT

When the economy is weak, officials often step up government spending to boost growth. But in the first half of 2011, such spending fell at a 3.5% annual rate.

That decline was partly due to budget woes in state and local governments, as well as what appears to be a one-time slump in defense spending. The main issue here is the Federal Government's deficit-reduction plan. It will include more spending cuts and increasing tax revenues; the pain is likely to persist.

TRADE

With the economy unable to depend as much on consumers, exports are one of the keys to U.S. growth. Trade contributed to the economy in the first half of the year, when U.S. exports grew a bit more quickly than imports. But the country is still running a trade deficit.

A weaker dollar should help the U.S. increase overseas sales of goods and services. But that, in turn, depends on world demand. Japan is still recovering from its earthquake, Europe is in the middle of a financial crisis, the UK is running with its own austerity measures and high interest rates in China, India and other emerging markets are all pushing against US growth.

Your Task:

Work out what has happened to the components of AD in the U.S. over the last 3 years and insert into the table:

AD =					

What reasons can you identify for the changes in the components of AD?

What has happened to the four key policy objectives?

Using an AD Diagram, briefly explain what has happened to U.S. Aggregate Demand in the first half of 2011?