At this point output is below potential and the price level is above equilibrium.

Here output is at potential and the price level is at equilibrium.

FIGURE 7.1 The Aggregate Demand (AD) Curve
FIGURE 7.2 Output Declines When AD Shifts Inward
FIGURE 7.3 A Price Shock

After the price shock, output is lower.

The initial point.

Price level ($P$) vs. output ($Y$) graph showing the effects of a price shock on output.
FIGURE 7.4 The Consumption Function

CONSUMPTION (C) (billions of dollars)

DISPOSABLE INCOME (Y_d) (billions of dollars)

Consumption function

\[ C = a + b Y_d \]

Slope = \( b = \frac{\Delta C}{\Delta Y_d} \)
The 45-degree line shows where spending and income are equal

Spending line = \( a + b(1 - t)Y + I + G + X \)

At this level of income, spending would fall short of the amount of income

At this level of income, spending would exceed the amount of income

FIGURE 7.5 Spending Balance
### TABLE 7.1 EXAMPLE OF THE MULTIPLIER PROCESS (BILLIONS OF DOLLARS)

<table>
<thead>
<tr>
<th>Reducing in GDP</th>
<th>This Round</th>
<th>Sum To Date</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round 1</td>
<td>10.000</td>
<td>10.000</td>
<td>Exogenous drop in investment</td>
</tr>
<tr>
<td>Round 2</td>
<td>6.300</td>
<td>16.300</td>
<td>$b(1 - t)[10] = (0.6300)[10]$</td>
</tr>
<tr>
<td>Round 3</td>
<td>3.969</td>
<td>20.269</td>
<td>[[b(1 - t)][10] = (0.3969)[10]]</td>
</tr>
<tr>
<td>Round 4</td>
<td>2.500</td>
<td>22.769</td>
<td>[[b(1 - t)]<a href="10">3</a> = (0.2500)[10]]</td>
</tr>
<tr>
<td>Round 5</td>
<td>1.575</td>
<td>24.344</td>
<td>[[b(1 - t)]<a href="10">4</a> = (0.1575)[10]]</td>
</tr>
<tr>
<td>Round 6</td>
<td>0.992</td>
<td>25.336</td>
<td>[[b(1 - t)]<a href="10">5</a> = (0.0992)[10]]</td>
</tr>
</tbody>
</table>
FIGURE 7.6 The Multiplier
FIGURE 7.7 The Government Spending Multiplier