Good example of essay on us agriculture: current scenario

Business, Marketing

DD Curve:

DD Curve is the summarized relationship between Exchange Rate and Ouput Level which shows all the combinations of output and the exchange rate for which the output market is in short run equilibrium i. e (aggregate demand= aggregate output)

E2

The above figure represents upward sloping DD Curve explaining the effect of movement in exchange rate on output level when both Domestic Price Levels(P) and Foreign Price Levels(P*) are fixed. The figure represents the effect of depreciation of domestic currency on domestic output levels and related aggregate demand. Thus, when domestic currency depreciates against foreign currency, it shifts the aggregate demand from E1 to E2 for both fixed level of prices at domestic level(P) as well as foreign levels(P*). As a result, with fixed price levels and with home currency depreciating, the foreign goods become more expensive and thus AD Curve shifts upward because with fall in price levels of domestic goods and services, both domestic and foreign demand for domestic output increases and thus, following relevant change in exchange rate, aggregate demand curve(DD) shifts upwards and so do the DD Curve because rise in exchange rate cause output to increase from Y’ to Y’’

Factors that shift DD Curve:

Following are the factors that shift DD Curve Schedule:

- Taxes

- Level of Government Demand

- Domestic and Foreign Price Levels

- Variations in Domestic Consumption Behavior
- Foreign Demand for Home Output
- Level of Investment

AA Curve:

AA Curve summarizes the relationship between exchange rates and output level that keep the money market and foreign exchange market in equilibrium. In other words, the scehdule of exchange rate and output combinations that are consistent with equilibrium in the domestic money market and the foreign exchange market is called the AA Schedule. Both, AA and DD Curve are necessary, as economy attains equilibrium when both output market and asset market are in equilibrium.

The diagram below shows the downward sloping AA Cuvre which indicates that any increase in output level i. e from Y’ to Y’’ will lead to appreciation of domestic currency and subsequent fall in the exchange rate from E1 to E2. Thus, this leads to fall in AA Curve schedule.

Factors that Shift AA Curve:

Following are the factors that shift AA Curve Schedule:

- Changes in Expected Future Exchange Rate-Ee
- Changes in Foreign Interest Rates- R*
- Shifts in Aggregate Real Money Demand Schedule
- Changes in Domestic Money Supply- Ms
- Changes in Domestic Price Levels- P

Equilibrium at interesction of DD Curve and AA Curve:

An Economy attains short run Equilibrium with the intersection of DD Scehdule and AA Schedule under the assumption of fixed output prices. Using DD Schedule which shows the equilibrium in output market and AA Curve which shows asset market are in equilibrium, we are able to derive two schedules of exchange rates and output levels.

Thus, the intersection of DD Curve and AA Curve leads to short run equilibrium because the intersection point brings out simultaneous equilibrium in output and asset markets.

DD

AA

Effect of Monetary and Fiscal Policy:

Both, Monetary and Fiscal Policies are the economic tools used by the government considering the desired economic situation in the country. Although, the intersection point of AA Curve and DD Curve provides equilibrium point, but government policies both monetary and fiscal policies can affect the affect the output and exchange rate equilibrium.

Fiscal Policy:

Fiscal Policies includes macro-economic decisions of the government relating to increase or decrease in government spending or taxation policies in order to promote economic welfare and well being in the nation. Any change in fiscal policy will have an impact on equilibrium output and exchange levels. For Instance, an increase in government expenditure or decision to cut taxation rates will lead to increase in government purchases and also high consumer spending following increase in disposable income levels. Thus, this result in rightward shift of demand curve and appreciation in currency rates following by increase in output levels and ultimately lead to high level of employment in the economy an vice versa.

DD’’

1

2

Effect of Monetary Policy:

Monetary Policies are related to increase or decrease in money supply by the government in welfare consideration of the economy based on prevailing circumstances. An increase in money supply will shift the AA curve upwards although it will have no effect on DD Curve. Following upward shift of the AA Curve will move the equilibrium point from point E to Point E’ with likely effect on exchange rate levels and output levels too. Thus, an expansionary monetary policy will lead to depreciation of domestic currency and expansion in output which ultimately leads to high employment figures and vice versa.

DD

E’

E

Works Cited

Krugman, O. a. (2013). Output and Exchange Rate in Short Run. In O. a. Krugman, International Economics (pp. 428-440). Boston: Pearson.