

Profits hit by rate rises



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Article Profits hit by rate rises The aggregate expenditure curve shows the relationship between the aggregate planned expenditure and the real GDP. The aggregate planned expenditure carries two components of autonomous expenditure as well as induced expenditure and the analysis of the curve therefore take into account the impacts of both the components of aggregate planned expenditures.

In theory, aggregate planned expenditure is always equal to the real GDP and there is a direct relationship between the two however deviations can occur in this relationship when the differences between the actual versus planned expenditure emerge. (McEachern, 2006) This difference however, appears in the form of inventories which start to accumulate when aggregate planned expenditure is less than the real GDP. The increase in the accumulation of inventories however reduces the GDP as firms tend to avoid the "overhang of unsold inventories" as mentioned in the article.

As real GDP converges to equilibrium i. e. aggregate planned expenditure starts to match real GDP, then the inventories of the firm start to draw down. If we take the scenario where inventories start to accumulate, a drift towards equilibrium would suggest that the planned expenditure exceeds real GDP hence in order to adjust the planned expenditure in line with the real GDP, inventories will start to reduce

As discussed above, there are two components of aggregate expenditure i. e. autonomous expenditure and induced expenditures. Autonomous, investments, exports expenditure include government spending as well as autonomous consumption. The induced expenditure most involves private consumption including imports, savings, consumer expenditure etc. The autonomous expenditure does not vary with the changes in the real GDP

therefore there is a very little impact of interest rises on this type of expenditure in short run. However, induced expenditure gets affected by the series of rises in interest rates. A series of increase in the interest rates would increase the demand for money within the economy therefore the consumption as well as investment portion of the induced expenditure would fall as consumers would prefer to save rather than spend.

With the increase in the price level, the disposable income of the consumers would start to fall thus creating a leftward shift into the aggregate expenditure curve. With the increase in the prices of oil, assuming that oil is used in manufacturing activities, there will be low level of investments from the firms to expand their production capacity therefore the induced investment would start to fall however this impact could hardly be witnessed in short term therefore the consistent increase in oil prices over the period of time would impact investment portion of the induced expenditure however in short run consumer spending would decrease since consumers have to pay greater portion of income to pay their fuel bills.

The available evidence suggest that there is going to be a decline in the real GDP over the next six months because rising oil prices would reduce the disposable income which would culminate further into piling up of inventories thus a reduced real growth in GDP.

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In order to analyse the impact of drought on long run as well as short run supply, we need to view it from two perspectives. In drought conditions, the food prices tend to increase due to shortages created by the natural conditions; this increase in the food prices reduces the aggregate demand (Blaikie, Cannon, Davis, & Wisner, 1998). However since there is also a

reduced output level due to drought therefore supply side also get affected at least in short run. However, if drought continues in long run, it can affect aggregate supply otherwise there is a very low probability of long run aggregate supply being affected by drought. In short run however, drought reduces aggregate supply.

As discussed above that droughts destroy the crops thus reducing the overall supply to the market therefore as a result, prices started to increase. The reduced supply coupled with increasing prices would decrease the aggregate demand due to decrease in quantity demanded because of increase in price. The impact of the drought therefore creates both i. e. supply side as well as demand side effects on the economy thus disturbing the whole equilibrium. Real Business Cycles Theory is a set of economic models which determine the fluctuations in the business cycles by attributing it to the real shocks rather than nominal shocks. Under this theory, the periods of economic growth as well as recessions are largely being viewed as a result of some exogenous changes that take place under real business environment.

In order to analyse the impact of drought on the capital as well as labor markets of Australia, in terms of real business cycle theory would be multiple in nature. Since under real business theory, fluctuations into the economy are attributed to the real events happening in the economy therefore the impact of drought on the labor, capital markets can be attributed to both direct as well as indirect effects. Labor market, especially those sectors which are associated with agriculture and live stock would greatly influenced by this drought. Since drought would created a strong reduction in demand and supply therefore this reduction would create a direct effect on agriculture production thus on the farmers. More and more farmers would be

rendered unemployed either due to their crops being destroyed by drought or there will be no one to purchase their produce. Further, since reduced agriculture output would mean reduced input in the form of raw materials to most of the companies therefore profitability of the firms would reduce thus greatly impacting capital markets.

Since reduced agriculture output would increase the price level therefore there will be a general increase in the overall price level in the economy when drought is prevailing. Apart from that, real business cycles theory build on rationale expectations therefore when consumers would accurately expect that future supplies are going to run into shortages therefore they would prefer to accumulate inventories with themselves rather than foregoing them to buy in future therefore this would result into reduced real GDP because of high inflation as well as reduced supply. (Cowen, 2004)

Bibliography

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