

Unit 4 Diagram Bank — Must-Know Macro Diagrams for the Exam

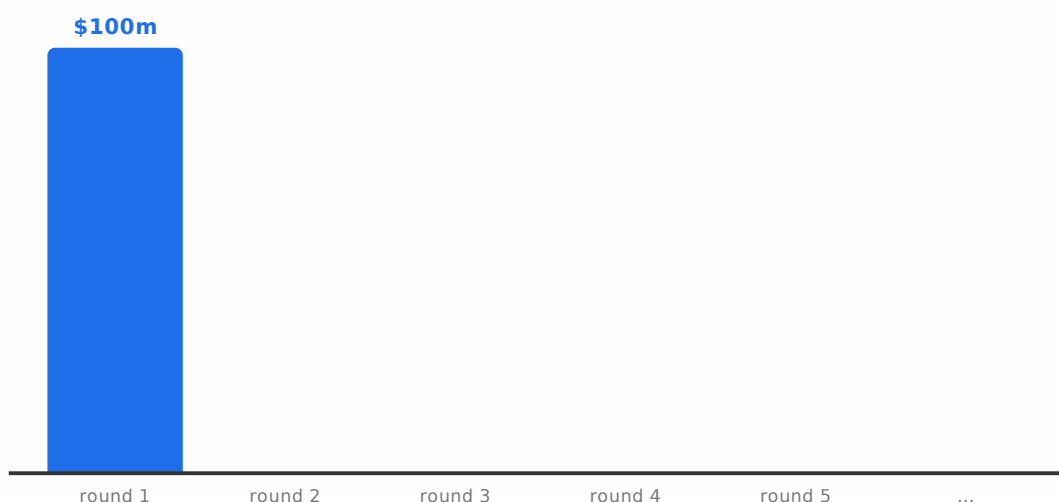
Every macroeconomic diagram you need for the Unit 4 examination, in one place. For each one: what it shows, how to draw it, and the point examiners most want to see. Cover the caption and try to reproduce each diagram from memory.

1. The multiplier process

An initial injection of spending sets off successive rounds of induced consumption. Each round is smaller because some income leaks to saving, so the total rise in output is a multiple of the original injection.

The multiplier process (MPC = 0.8, initial injection \$100m)

Spending added (\$m)



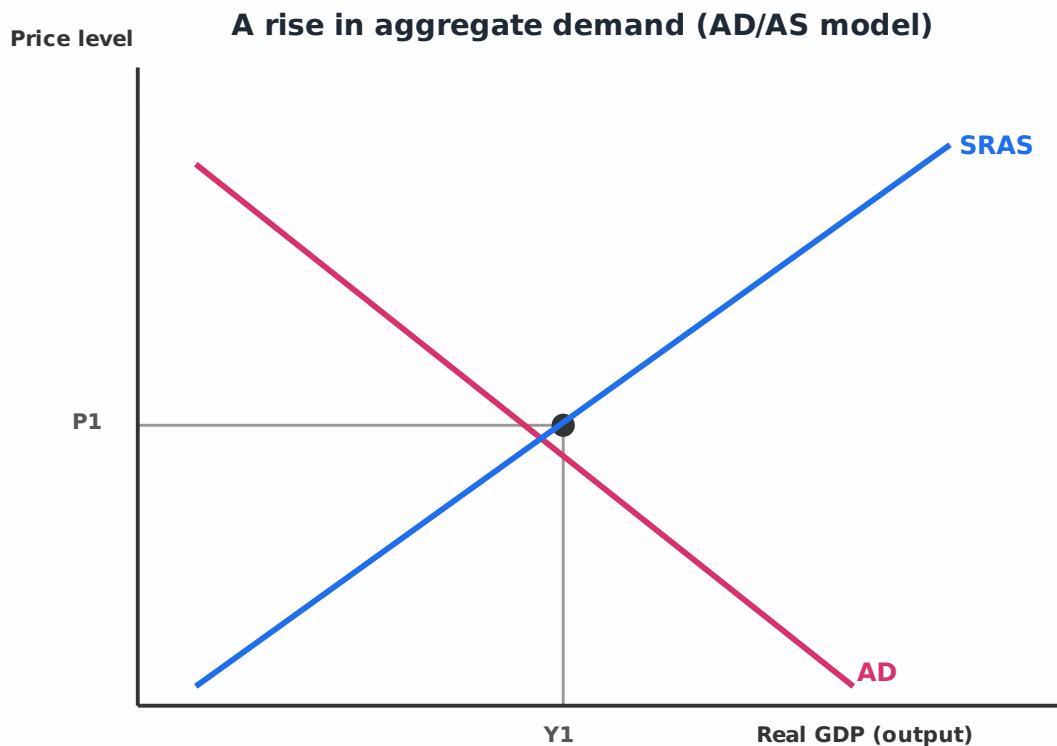
$$\text{Total } \Delta Y = \$100m \times 1/(1-0.8) = \$500m$$

Show the initial injection, then shrinking successive rounds, summing to the final change in output. The multiplier $k = 1 \div (1 - MPC) = 1 \div MPS$.

Watch for: State and use the multiplier formula. With MPC = 0.8, $k = 5$, so a \$100m injection raises output by \$500m.

2. The AD/AS model

Aggregate demand slopes down, short-run aggregate supply slopes up, and their intersection sets the price level and real output together. A demand shift moves both.

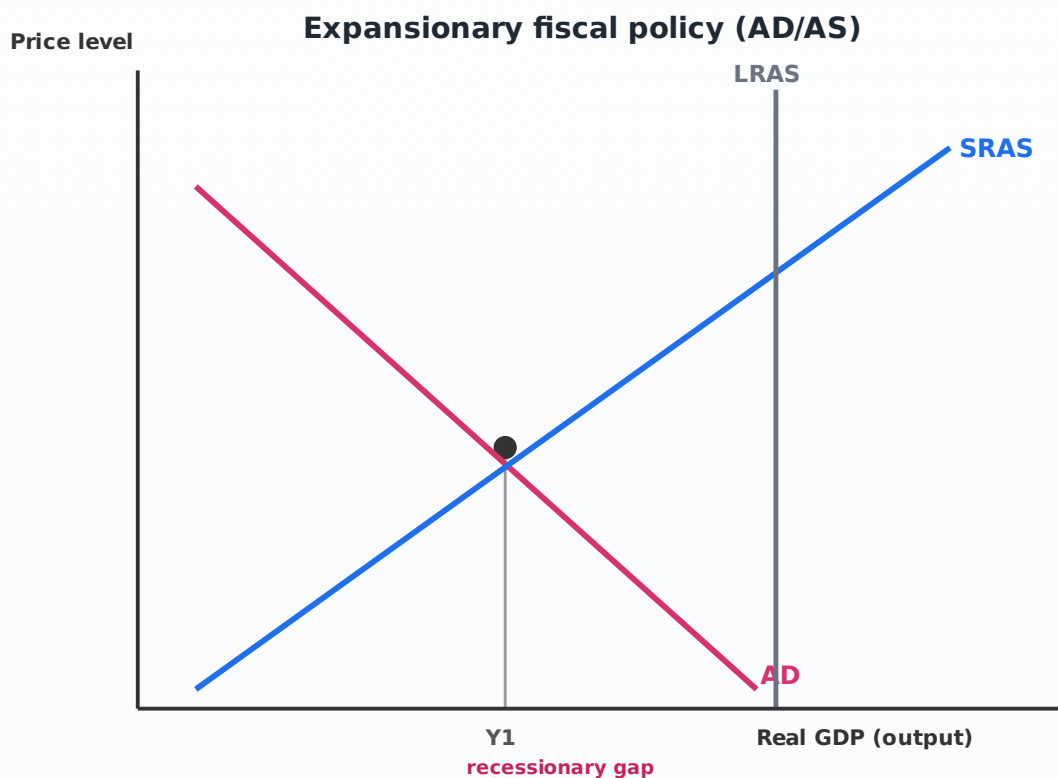


Axes are price level (vertical) and real GDP (horizontal). Shift AD right (e.g. $AD \rightarrow AD_2$) and read the new equilibrium: higher price level and higher output.

Watch for: Always read off BOTH the price level and real output at the new equilibrium — losing the 'both' costs marks.

3. Expansionary fiscal policy

A higher G or lower T raises aggregate demand, shifting AD right toward the vertical $LRAS$ and closing a recessionary output gap.



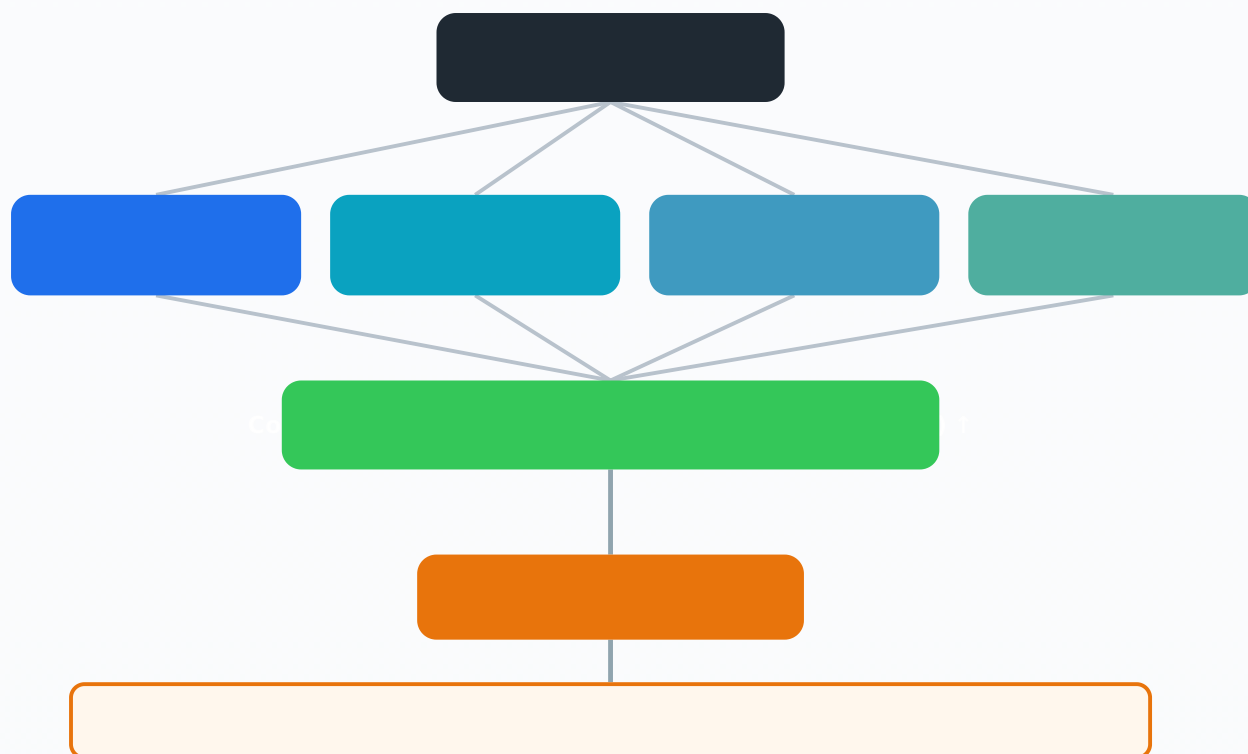
Draw AD, SRAS and a vertical LRAS. An expansionary stance shifts AD right; mark the recessionary gap closing and the rise in output.

Watch for: Name the stance (expansionary/contractionary) AND show the AD direction. Connect the size of the shift to the multiplier.

4. Monetary transmission mechanism

A cash-rate change does not affect the economy directly — it works through channels (lending rates, the exchange rate, asset prices/wealth, household cash flow) that together move aggregate demand.

Monetary policy transmission mechanism (a cash-rate cut)

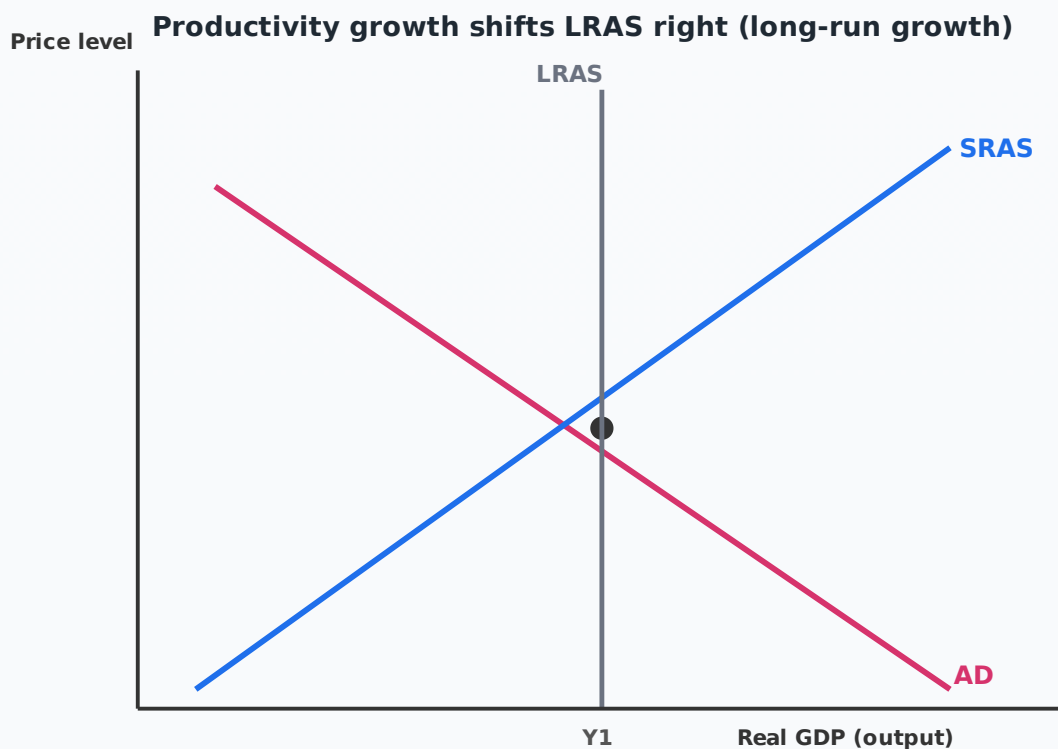


Draw the flow: cash rate → the four channels → C, I and net exports → aggregate demand → output, employment and inflation.

Watch for: Name the channels and always finish at aggregate demand and then the macro objectives. Stress the long, variable lag.

5. Long-run growth (LRAS shift)

A rise in labour productivity raises potential output, shifting the vertical LRAS to the right. With AD unchanged, output rises and the price level eases — non-inflationary growth.



Draw a vertical LRAS and shift it right to LRAS₂. The new equilibrium sits at higher output and a lower price level.

Watch for: Distinguish an LRAS shift (capacity, supply-side) from an AD shift (demand-side). Only the LRAS shift raises long-run living standards.

These five diagrams carry the analytical weight of Unit 4. If you can draw each one — labelled, with the shift and new equilibrium marked — and explain what moves and why, you are ready for the macro-policy questions in the examination.