14 December 2023 08:18 PM

1. Cardinal utility and Ordinal utility

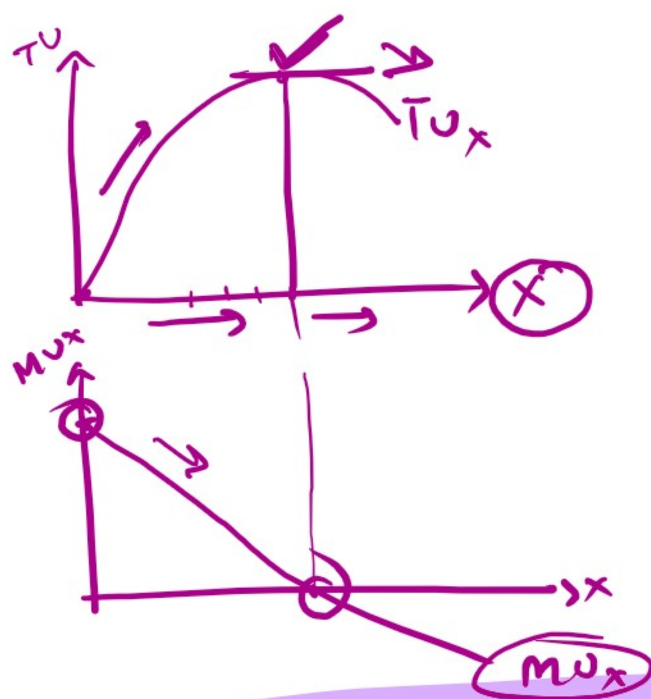
Cardinal → numbers in monetary terms.

Ordinal → ranking according to preferences → Indifference curve analysis.

⊙ Definition — eGyan Kosh

unit 5 Consumer Equilibrium

$$MU_x = \frac{\Delta TU_x}{\Delta x}$$



Ordinal Approach (Indifference Curve Analysis)

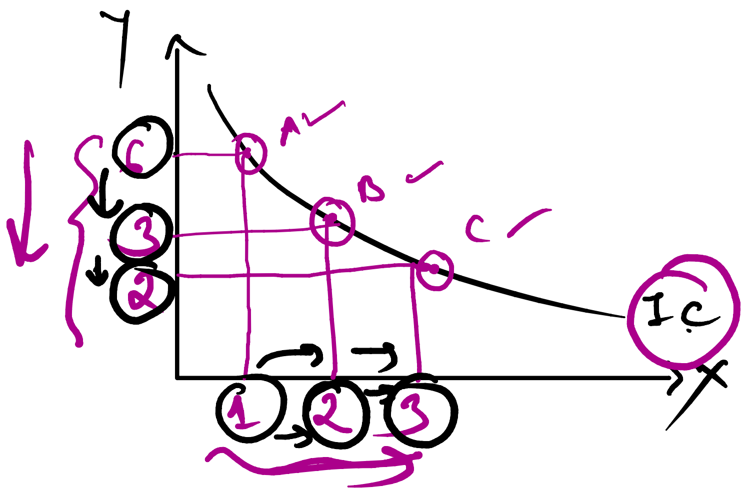
(Ranking according to preference)

· Preference Theory

→ Preference Theory

What is indifference curve?

$U = U(X, Y)$



Satisfaction / utility is constant

Properties ① downward sloping (move in opposite direction)

$$slope = \frac{\Delta Y}{\Delta X} = -\frac{MU_x}{MU_y}$$

② IC is convex due to diminishing marginal rate of substitution

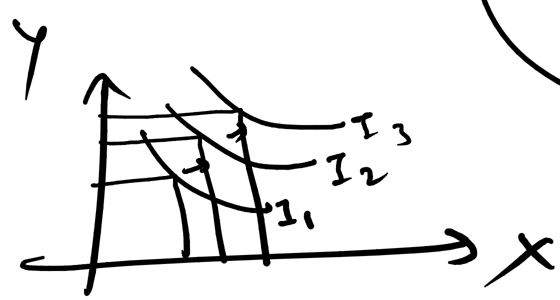
MRS

MRS → for every additional unit of X consumption amount of Y consumption that is amount of Y consumption that

sacrificed or given to keep the level of satisfaction constant (TU).

This rate of substitution that is amount of Y substituted X is decreasing for every 1 unit X.

③ Higher the IC → higher the level of satisfaction



Budget Line :

X P_x + Y P_y

$E \Rightarrow xP_x + yP_y$

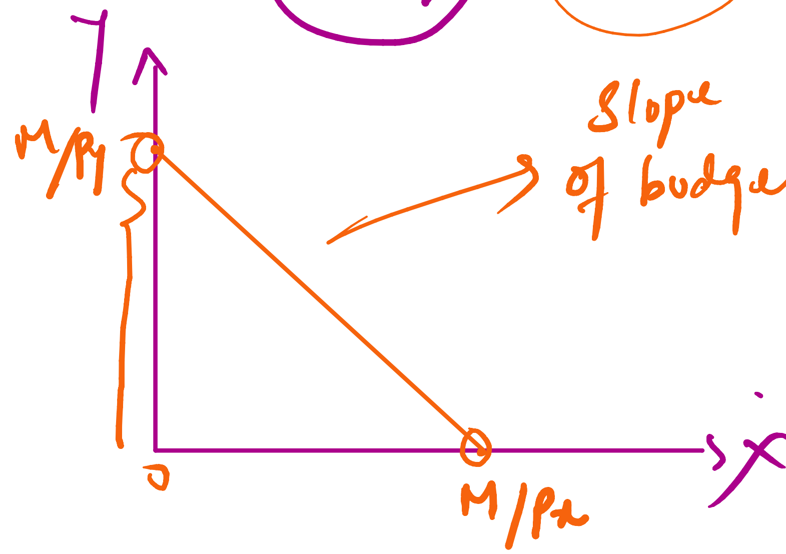
$M \Rightarrow$ income

budget constraint

$M \leq xP_x + yP_y$

budget equation $M = xP_x + yP_y$

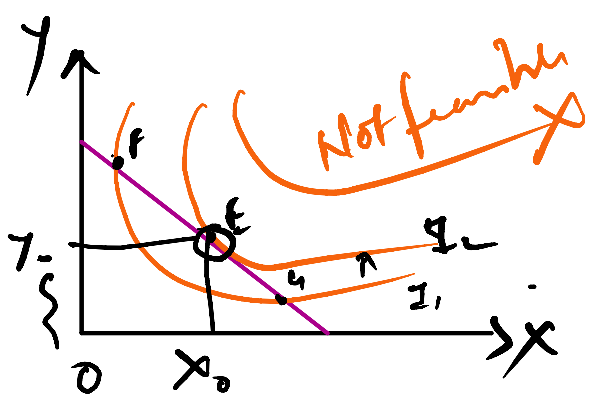
Budget equation: $M = x P_x + y P_y$



Slope of budget $= \frac{\Delta y}{\Delta x} = -\frac{P_x}{P_y} < 0$

Consumer's equilibrium → utility maximisation with given amount of income.

(How many x and y units can be purchase with given M, such that consumer's utility is maximum)



point E is consumer's equilibrium.

slope of IC = slope of budget line

$$\cancel{-}\frac{MU_x}{MU_y} = \cancel{-}\frac{P_x}{P_y}$$

...umer's ...

$$MU_x = P_x$$

Consumer's equilibrium $\rightarrow$ $\boxed{\dfrac{MU_x}{MU_y} = \dfrac{P_x}{P_y}}$

Macroeconomics

1. Functions of money $\rightarrow$
   1. Exchange
   2. Store of value
   3. Standard of unit
   4. Standard of deffered payments

2. Money supply concept $\rightarrow$ M_1, M_2, M_3, M_4

   Near money

3. Functions of RBI (important).

4. Types of inflation
   - Demand pull
   - Cost-push.

Demand Pull inflation

$\downarrow$

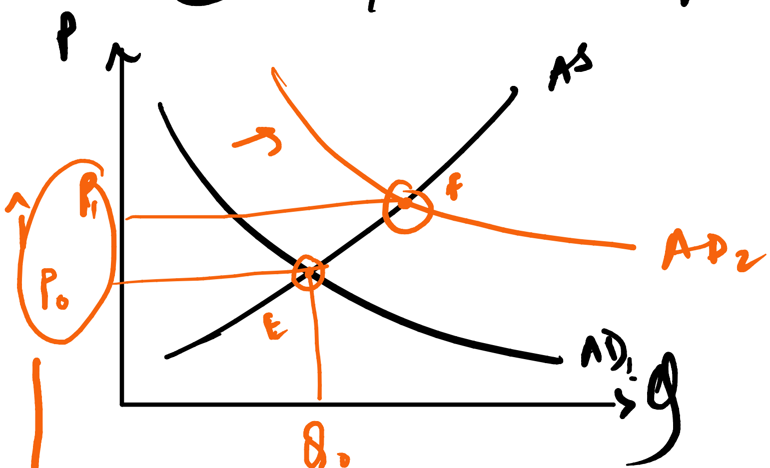
Demand

↓
excess demand → when Aggregate Demand exceeds Supply

Reasons:

1. Growing Economy :
2. export increase :
3. Government Spending

AD demand increase (Demand shifts right)
To maintain equilibrium price in economy increases as shown in diagram

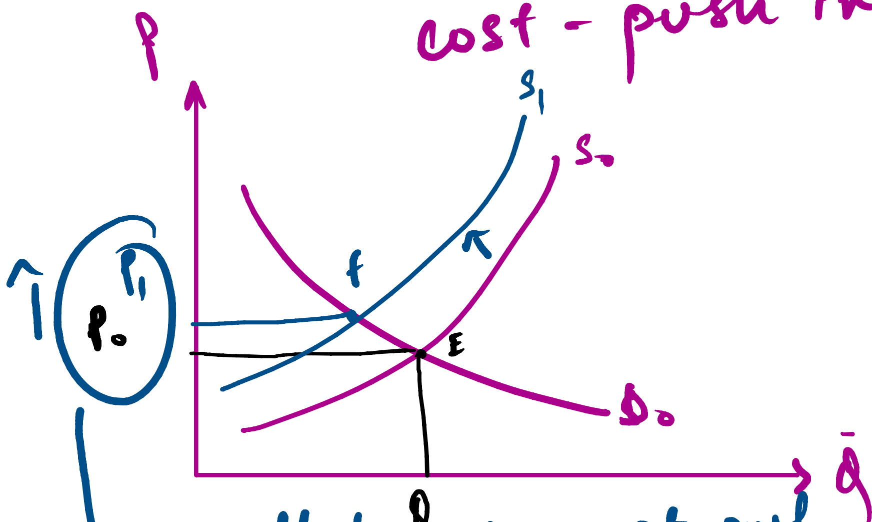


↳ inflation
↳ demand-pull inflation.

Cost-push inflation

↓
increase in cost of production (for example due to increase in price of raw materials)
↓
decrease in production
↓

↓
supply decrease
↓
supply curve shifts left
↓
shortage
↓
to manage excess demand due to shortage price will increase.
↓
cost-push inflation.



→ inflation → cost-push.