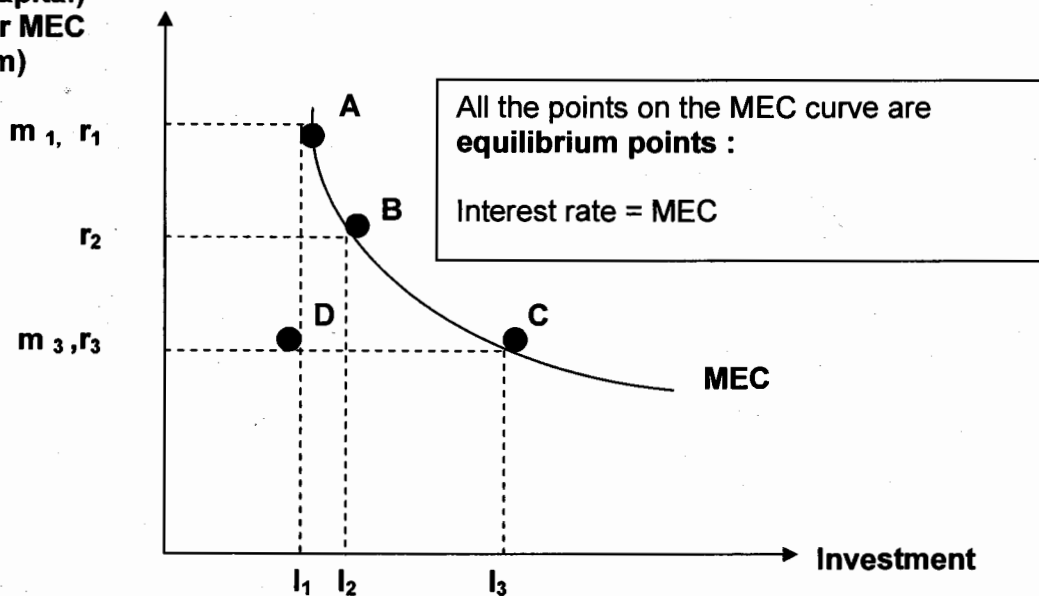


Interest Rate (r)  
%  
(price of capital)  
or MEC  
(m)

## THE MEC CURVE



The MEC curve shows the relationship between the level of investment at each level of interest rate.

There is an inverse  $r/s$  between the market  $i/r$  & MEC, so a fall in  $r$  will result in a rise in  $I \Rightarrow$  shown by a movement along the MEC curve.

However, any non-interest factors will result in a shift of the MEC curve. Eg a increase in business confidence ('animal spirit')  $\Rightarrow$  MEC shift right

### How to read the diagram:

A point D (which is not on the MEC curve) does not show equilibrium level of investment eg for the level of investment ( $I_1$ ) at point D,

MEC (with MEC at  $m_1$ , shown by point A)  $>$  interest rate of  $r_3$ ,  
Hence level of investment will increase until  $I_3$ ,  
when interest of  $r_3 = \text{MEC} (m_3)$

Most diagrams only label the Y axis as interest rate alone as they want to focus on the relationship between rate of interest (the price of capital) & level of Investment.

Though it may not be wrong to include  $m$  (representing rate of return or MEC) in the label of the Y axis. (In fact some books, include both  $r$  &  $m$  when labelling the Y axis)

- Technically, the Y axis should be labelled as interest rate ( $r$ ) – ie the price of capital, and the X axis, quantity (level) of investment