



Aggregate Supply

The *quantity of real GDP supplied* is the total quantity that firms plan to produce during a given period

Aggregate supply is the relationship between the quantity of real GDP supplied and the price level



Short Run vs. Long Run

We distinguish two time frames associated with different states of the labor market:

- Short-run aggregate supply – nominal wages do not change
- Long-run aggregate supply – nominal wages change



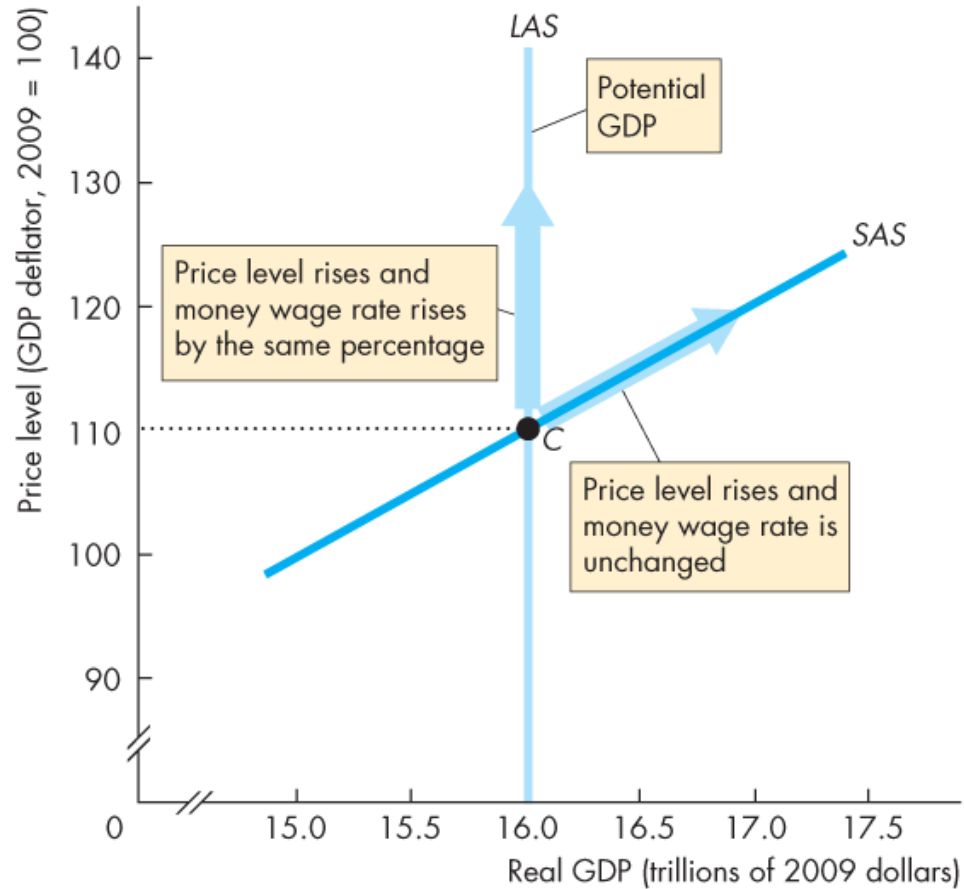
Short Run and Long Run Aggregate Supply

Short-run aggregate supply is the relationship between the quantity of real GDP supplied and the price level when the nominal wages, the prices of other resources, and potential GDP remain constant

Long-run aggregate supply is the relationship between the quantity of real GDP supplied and the price level when real GDP equals potential GDP

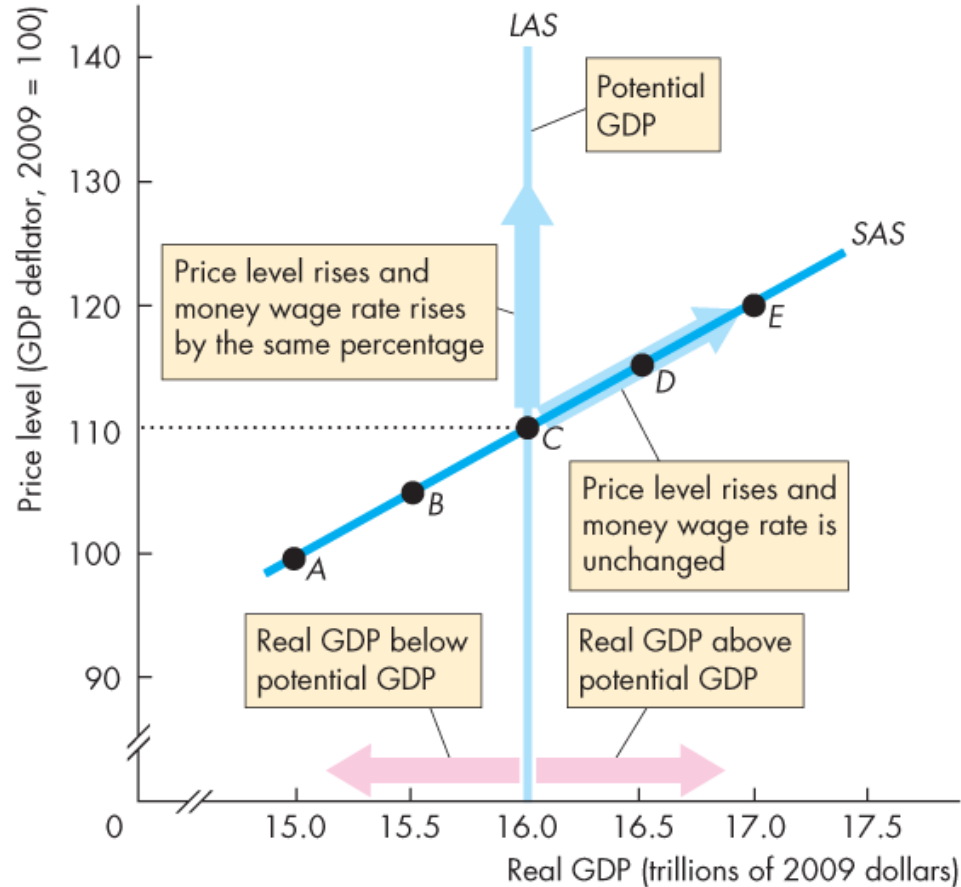


Short Run and Long Run Aggregate Supply





Short Run and Long Run Aggregate Supply





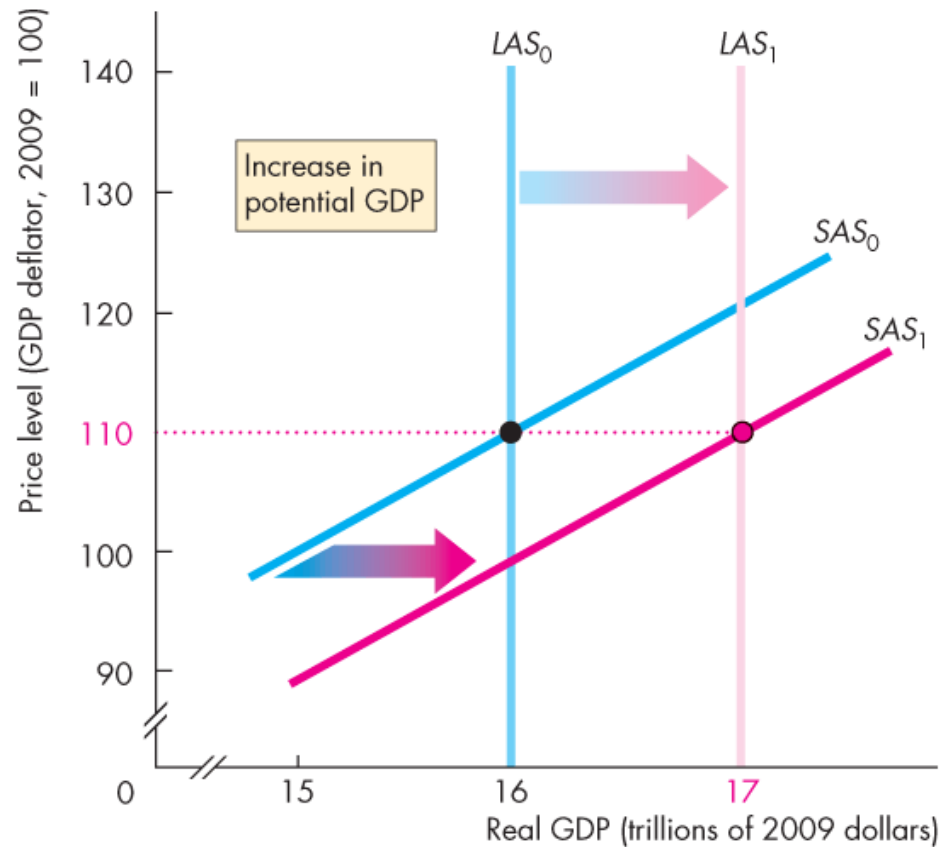
Increase in Potential GDP

Potential GDP increases for three reasons:

- An increase in the full-employment quantity of labor
- An increase in the quantity of capital (physical or human)
- An advance in technology



Increase in Potential GDP





Aggregate Demand

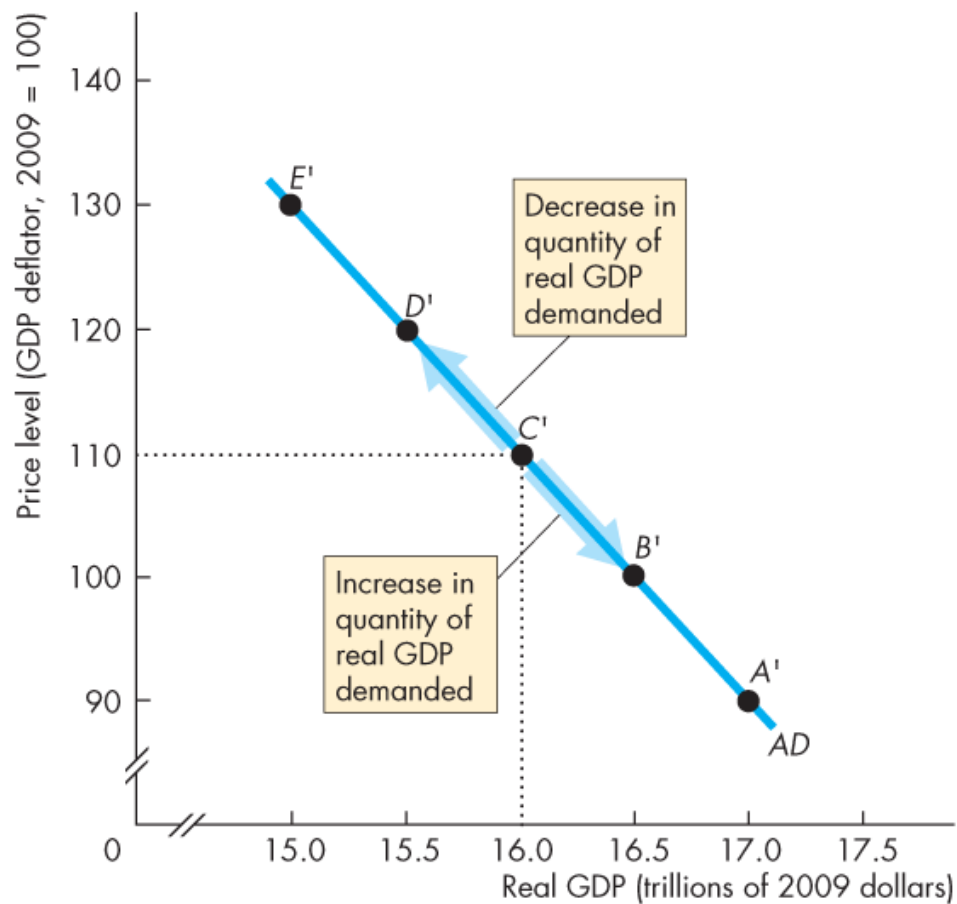
The quantity of real GDP demanded:

$$Y = C + I + G + X - M$$

Aggregate demand is the relationship between the quantity of real GDP demanded and the price level



Aggregate Demand Curve



Why Is AD Curve Downward Sloping?

Income/Wealth Effect

A rise in the price level, all else held constant, decreases real wages and real wealth



People increase saving and decrease spending



The quantity of real GDP demanded decreases

Why Is AD Curve Downward Sloping?

Substitution Effect

A rise in the price level, all else held constant, decreases the real value of money



interest rates rise



people borrow and spend less



the quantity of real GDP demanded decreases



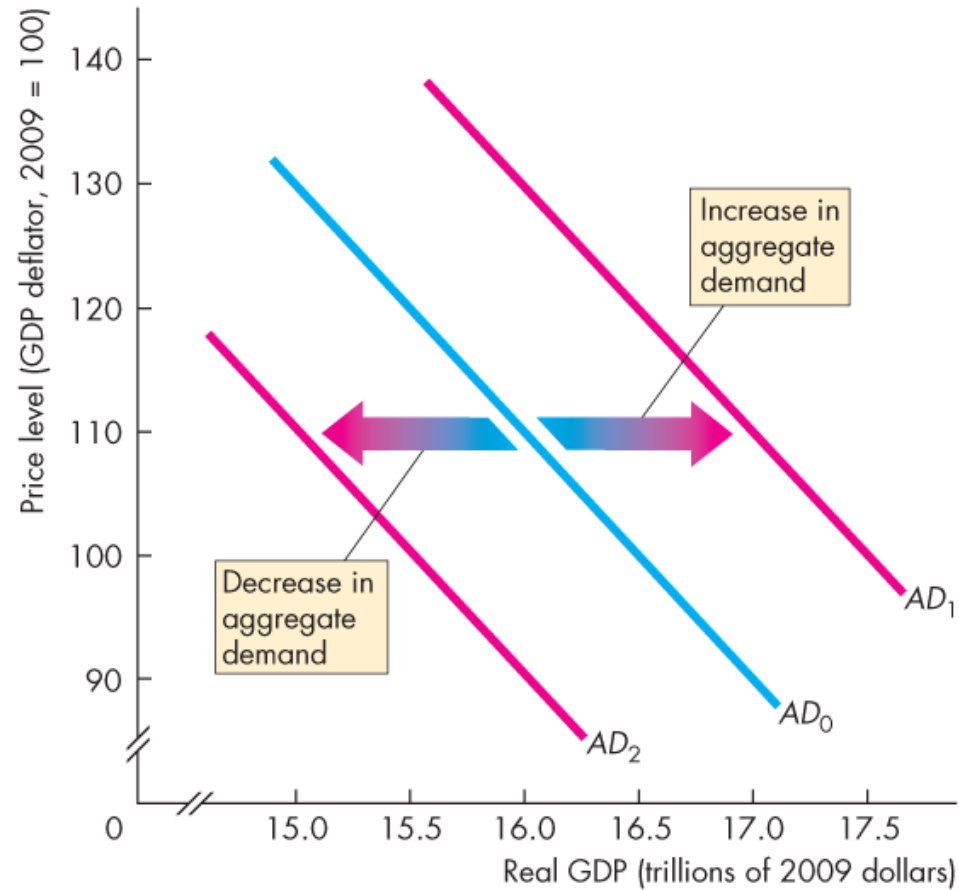
Changes in Aggregate Demand

Aggregate demand curve shifts because of:

- Expectations about future incomes and inflation
- Fiscal policy and monetary policy
- The world economy



Changes in Aggregate Demand



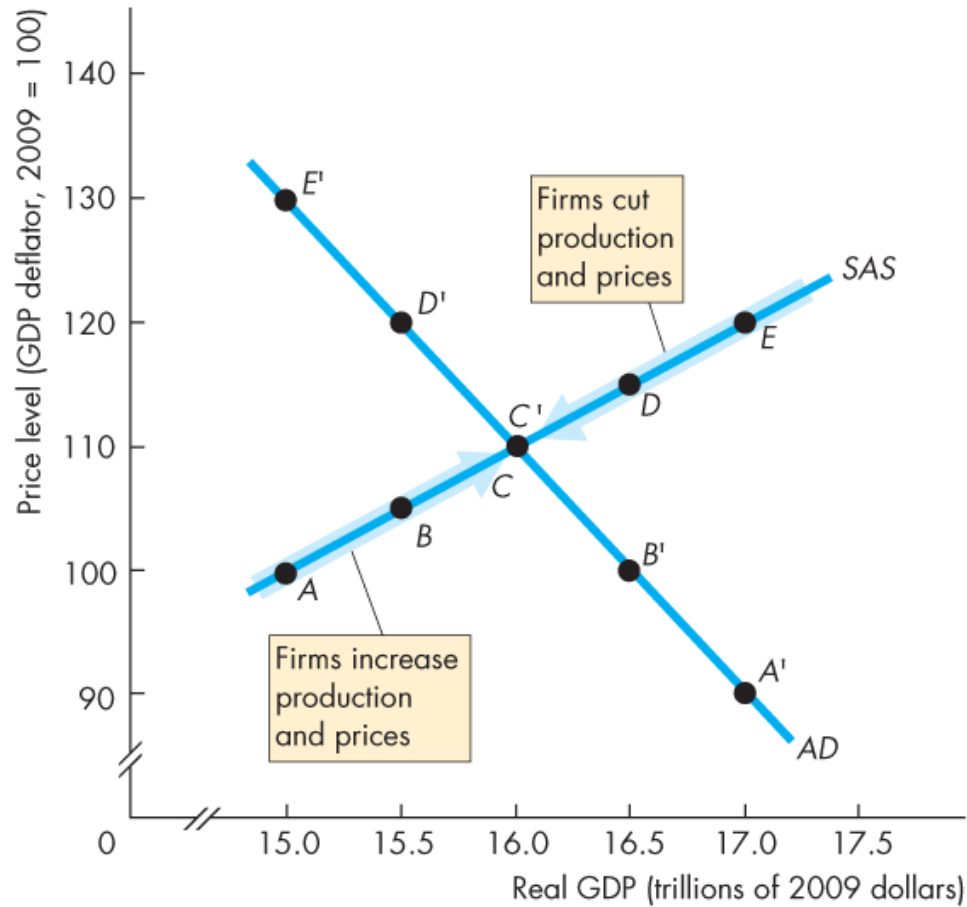


Short-Run Macroeconomic Equilibrium

Short-run macroeconomic equilibrium occurs when the quantity of real GDP demanded equals the quantity of real GDP supplied at the point of intersection of the *AD* curve and the *SAS* curve



Short-Run Macroeconomic Equilibrium





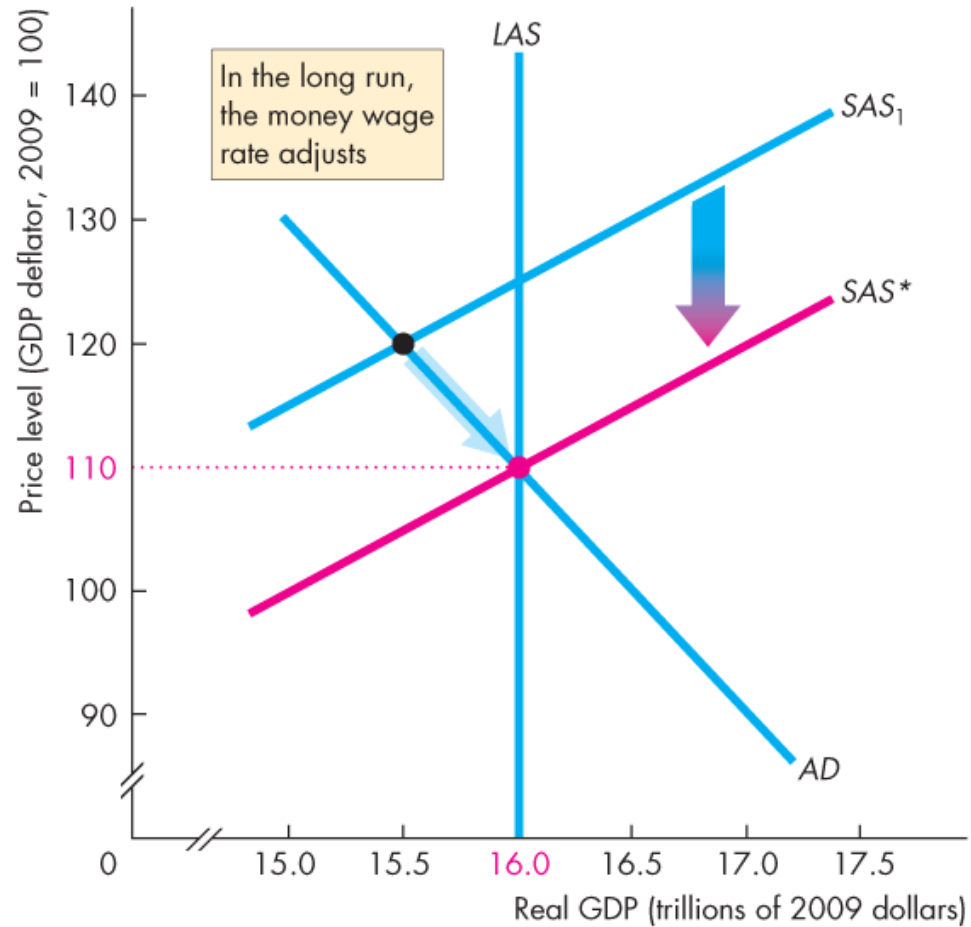
Long-Run Macroeconomic Equilibrium

Long-run macroeconomic equilibrium occurs when real GDP equals potential GDP – when the economy is on its *LAS* curve

Long-run equilibrium occurs at the intersection of the *AD* and *LAS* curves

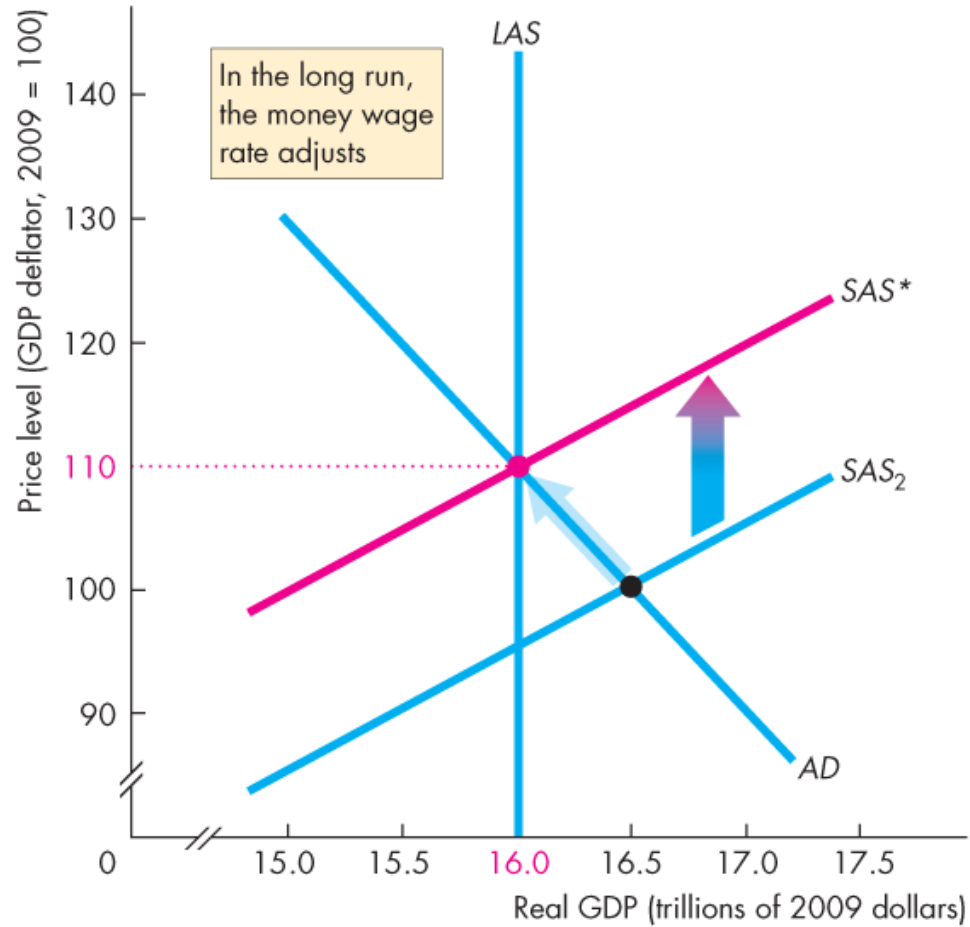


Long-Run Macroeconomic Equilibrium



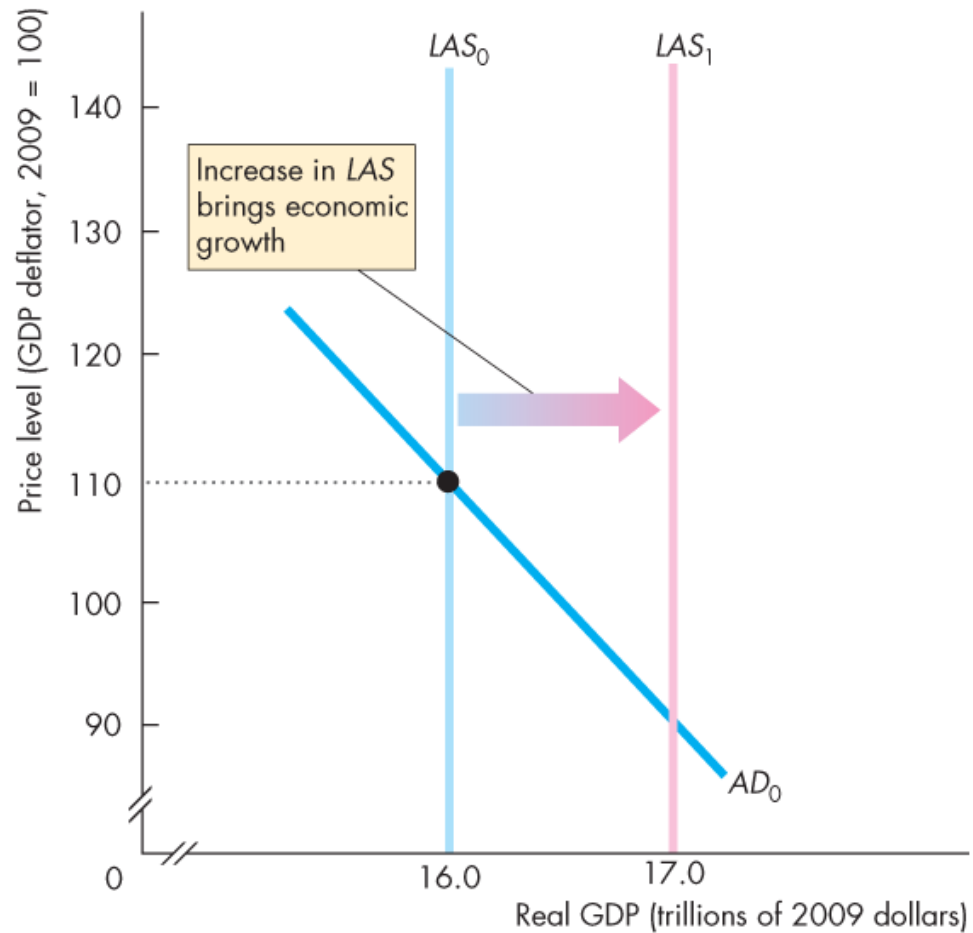


Long-Run Macroeconomic Equilibrium





Economic Growth in The AS-AD Model





Inflation in The AS-AD Model

