

 **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

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 **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

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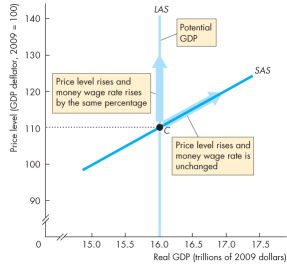
 **Short Run and Long Run Aggregate Supply**

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

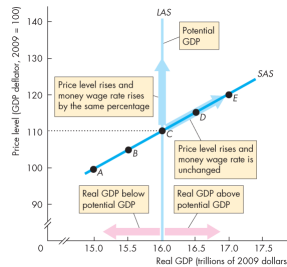
Long-run aggregate supply is the relationship between the quantity of real GDP supplied and the price level when real GDP equals potential GDP

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Short Run and Long Run Aggregate Supply



Short Run and Long Run Aggregate Supply

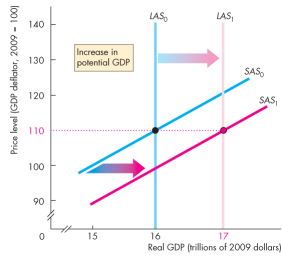


Increase in Potential GDP

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



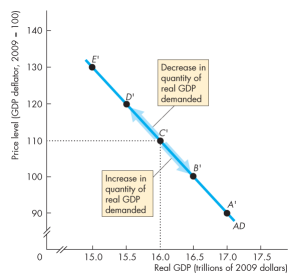
Aggregate Demand

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

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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

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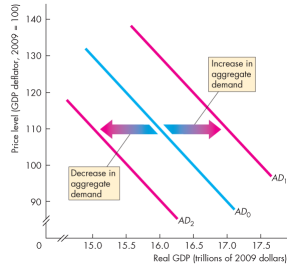
Changes in Aggregate Demand

Aggregate demand curve shifts because of:

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

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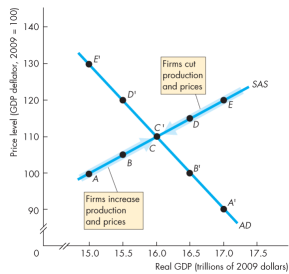
Changes in Aggregate Demand



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



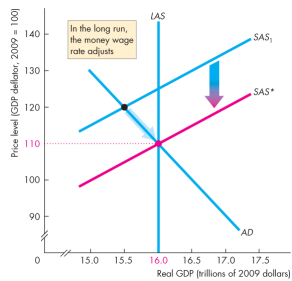
Long-Run Macroeconomic Equilibrium

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

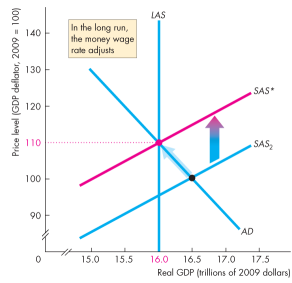
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Long-Run Macroeconomic Equilibrium



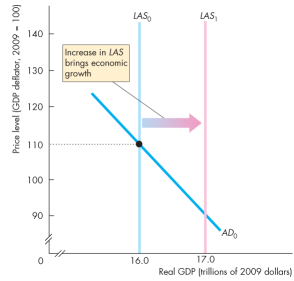
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Long-Run Macroeconomic Equilibrium



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Economic Growth in The AS-AD Model



Inflation in The AS-AD Model

