

● 27 Aggregate Demand

● 28 Aggregate Supply

● 29 The AD-AS Model



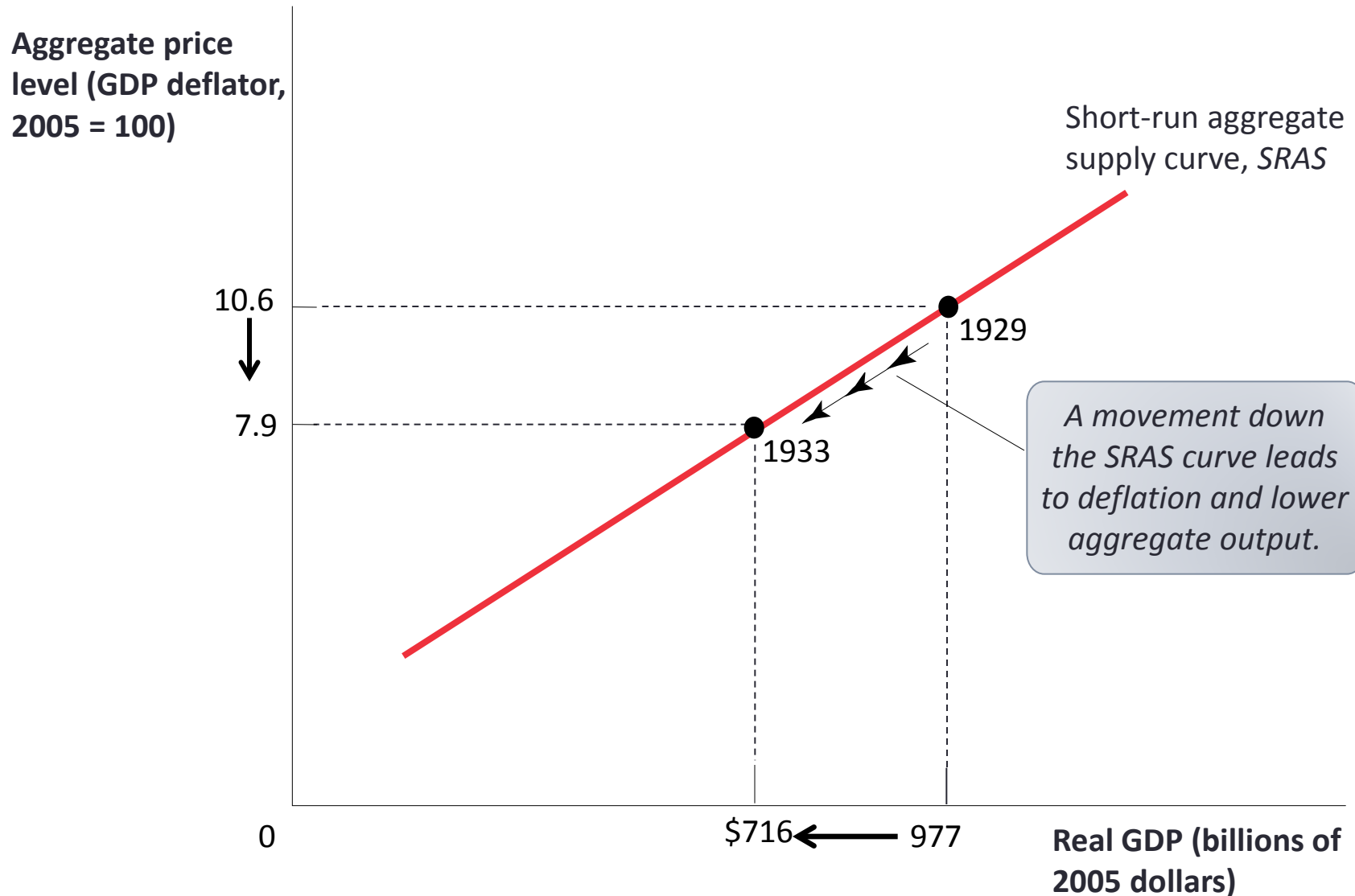
The Aggregate Supply Curve

- The **aggregate supply curve** shows the relationship between the aggregate price level (P) and the quantity of aggregate output (Y) in the economy.

The Short-Run Aggregate Supply Curve

- The **short-run aggregate supply curve** is upward-sloping because nominal wages are sticky in the short run:
 - a higher aggregate price level leads to higher profits and increased aggregate output in the short run.
- The **nominal wage** is the dollar amount of the wage paid.
- **Sticky wages** are nominal wages that are slow to fall even in the face of high unemployment and labor shortages.

The Short-Run Aggregate Supply Curve



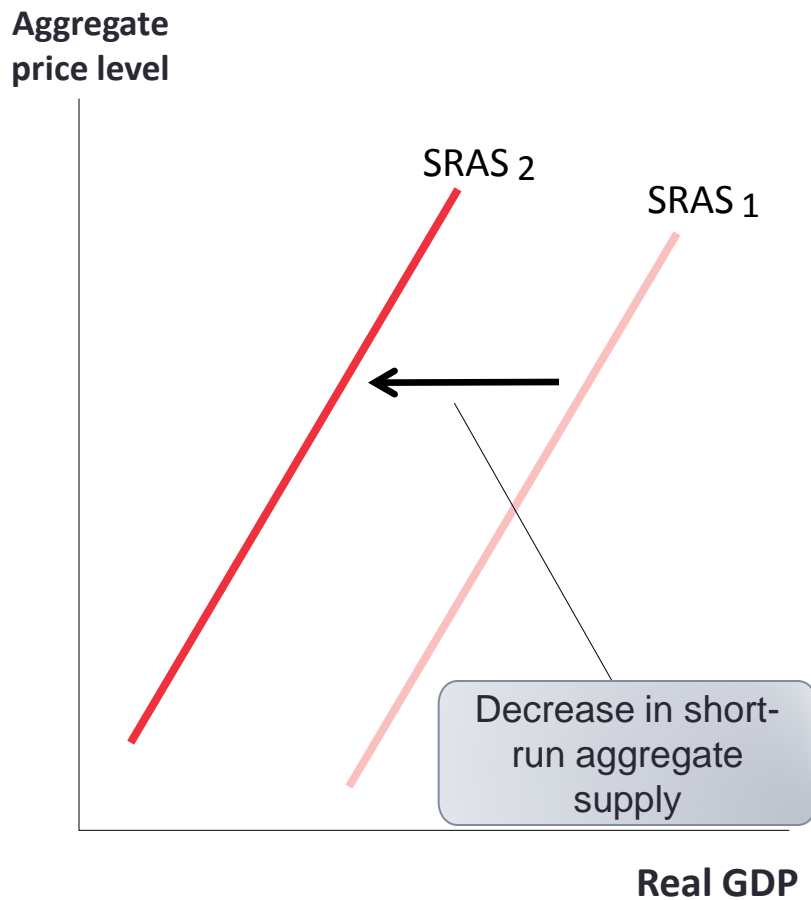
Shifts of the Short-Run AS Curve

- Changes in commodity prices, nominal wages, or productivity lead to changes in producers' profits and shift the short-run aggregate supply curve.

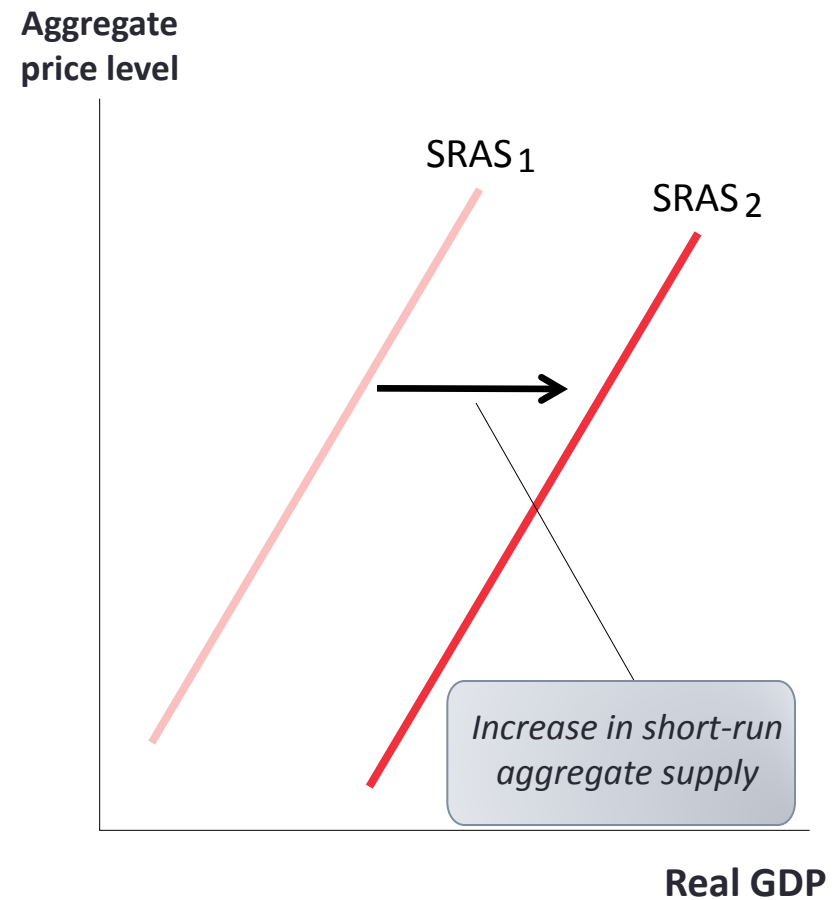


Shifts of the Short-Run AS Curve

(a) Leftward Shift



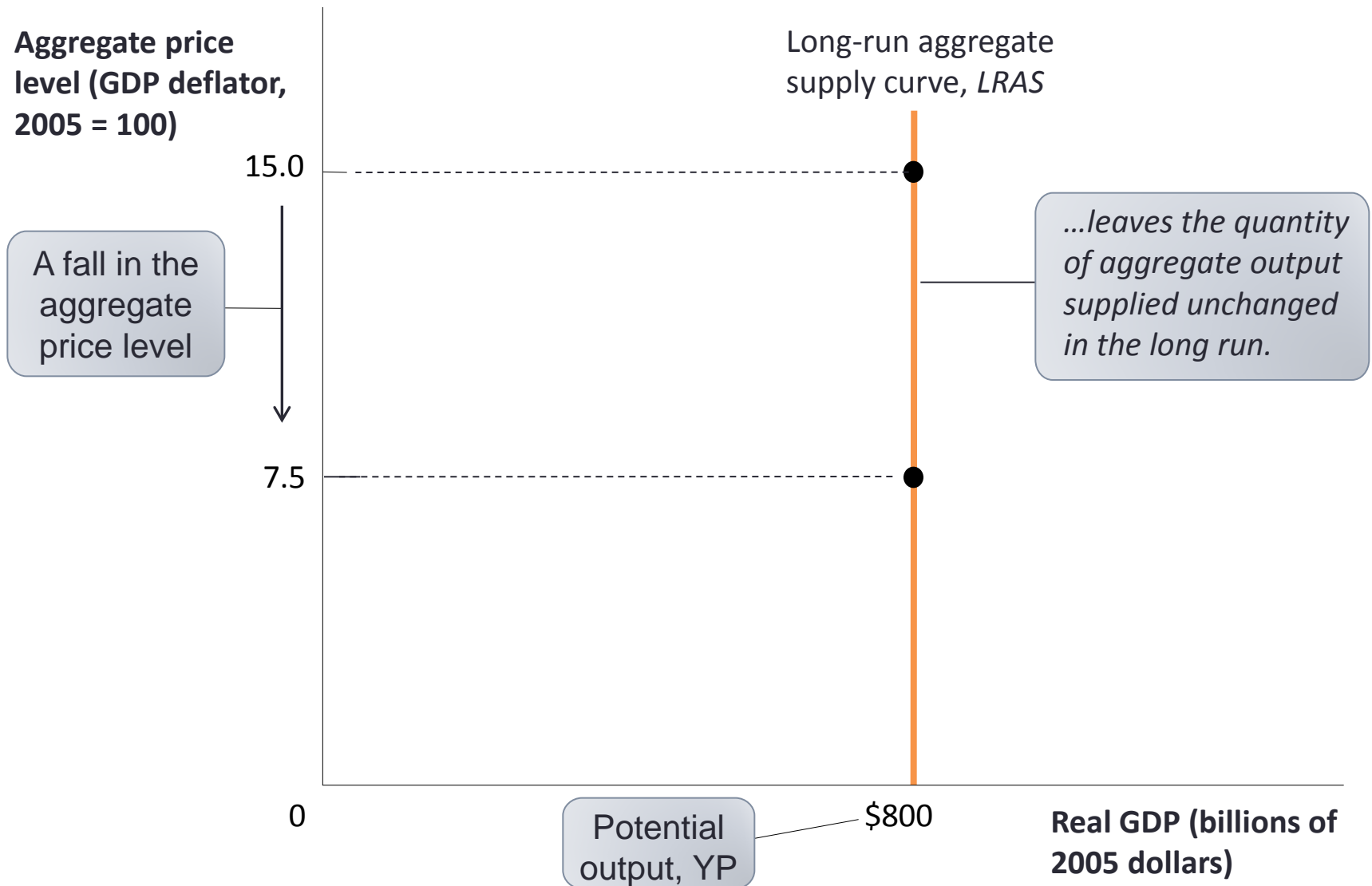
(b) Rightward Shift



Long-Run Aggregate Supply Curve

- The **long-run aggregate supply curve** shows the relationship between the aggregate price level (P) and the quantity of aggregate output (Y) supplied that would exist if all prices, including nominal wages, were fully flexible.

Long-Run Aggregate Supply Curve

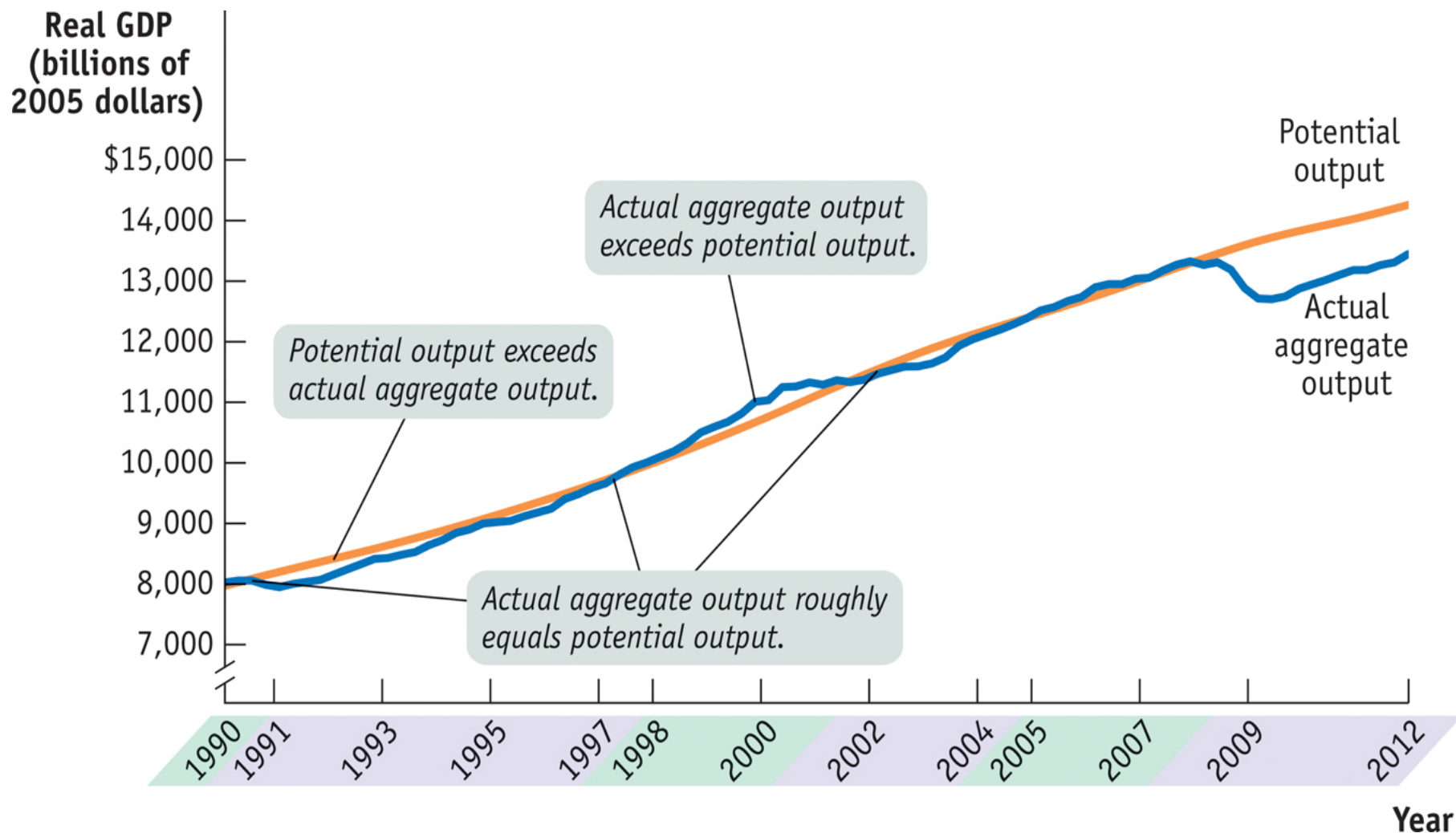


Actual and Potential Output

- There is a **recessionary gap** when aggregate output is below potential output.
- There is an **inflationary gap** when aggregate output is above potential output.
- The **output gap** is the percentage difference between actual aggregate output and potential output.

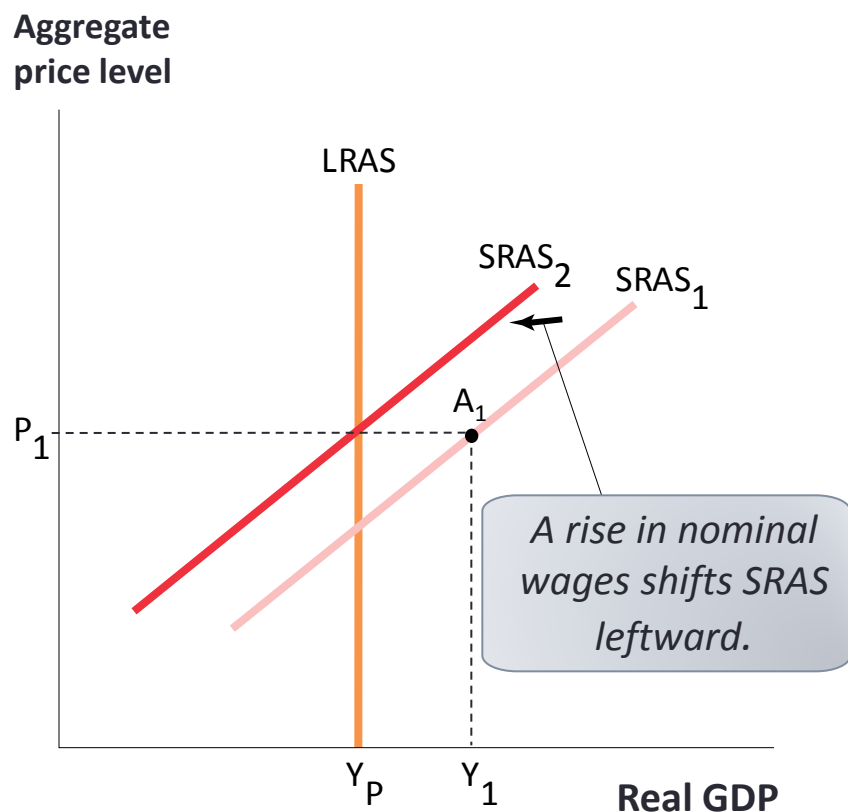
$$\text{Output gap} = \frac{\text{Actual aggregate output} - \text{Potential output}}{\text{Potential output}} \times 100$$

Actual and Potential Output (1989 – 2009)

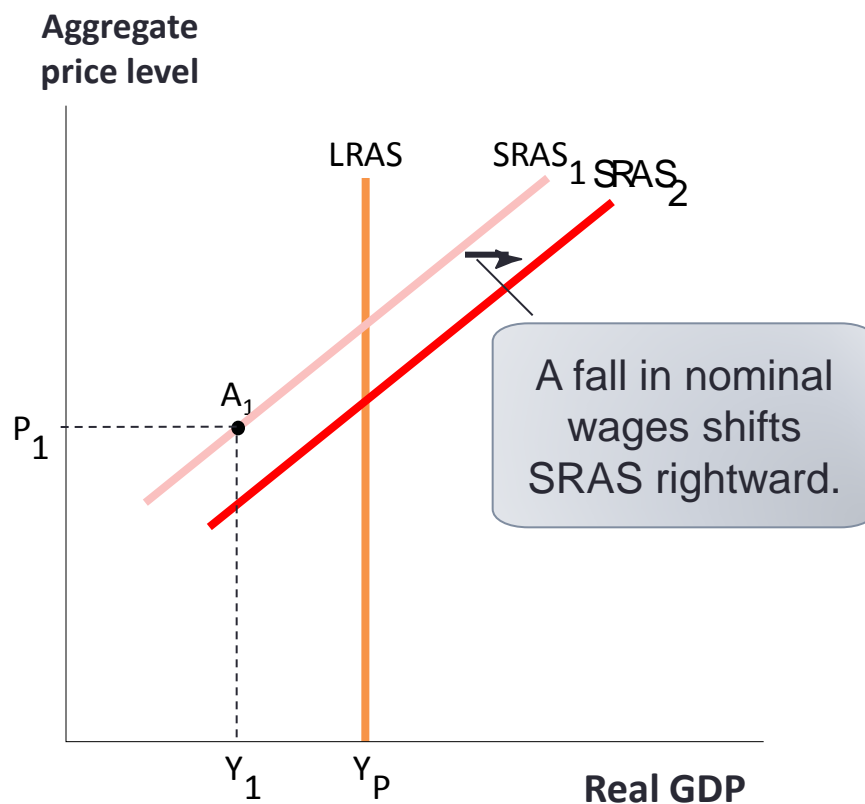


From the Short Run to the Long Run

(a) Leftward Shift of the Short-Run Aggregate Supply Curve



(b) Rightward Shift of the Short-Run Aggregate Supply Curve



Economics in Action

Prices and Output During the Great Depression

