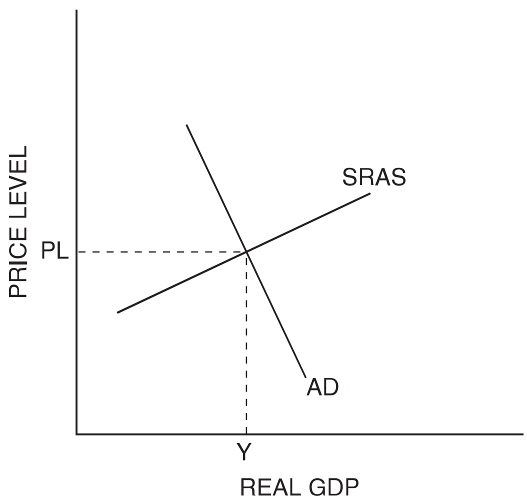
Short-Run Equilibrium Price Level and Output

The first section of the course presented the supply and demand model as a way to determine price and quantity in individual markets. The aggregate supply (AS) and aggregate demand (AD) model uses AS and AD to determine the equilibrium price level and aggregate quantity of output (real GDP) in the economy. It is important to correctly label the AS/AD graph to distinguish it from the market supply and demand graph. As shown in Figure 3-5.1, the axes labels should clearly indicate price level (PL), real GDP (Y), AS, and AD. Equilibrium in the model is found at the intersection of AS and AD. The equilibrium PL is identified on the vertical axis and the equilibrium Y is found on the horizontal axis.

***Student Alert:* Make sure you label the equilibrium values on the axes rather than as a point in the middle of the graph.**

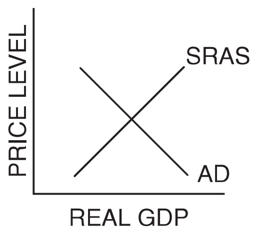
Figure 3-5.1
Equilibrium Price and Output Levels



Summarizing Aggregate Demand and Aggregate Supply Shifts

For each of the graphs below, identify the starting equilibrium PL and Y. Then show the shift given for each graph and identify the new equilibrium PL and Y. Indicate the resulting change in price level, unemployment, and real GDP by circling the up arrow for an increase or the down arrow for a decrease.

1. Increase in AD

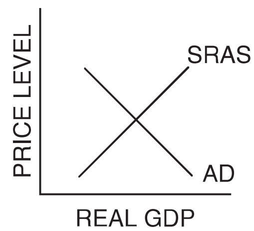


Real GDP: ↑ ↓

Price level: ↑ ↓

Unemployment: ↑ ↓

2. Increase in AS

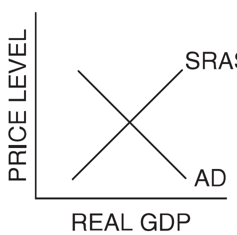


Real GDP: ↑ ↓

Price level: ↑ ↓

Unemployment: ↑ ↓

3. Decrease in AD

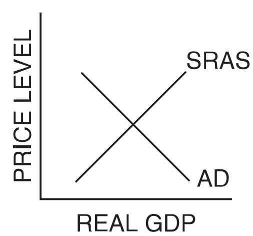


Real GDP: ↑ ↓

Price level: ↑ ↓

Unemployment: ↑ ↓

4. Decrease in AS



Real GDP: ↑ ↓

Price level: ↑ ↓

Unemployment: ↑ ↓

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