Unit 6, Lesson 38

Activity 3

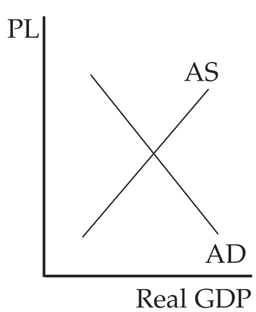
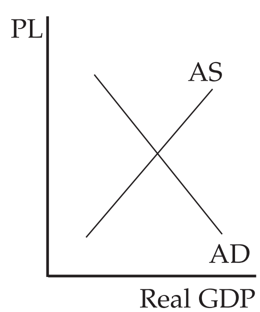
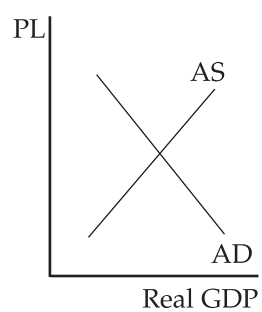
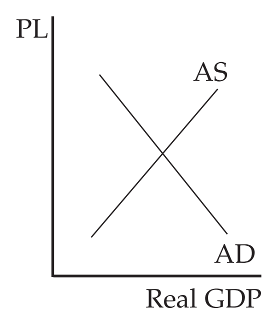
The Effects of Shifts in Aggregate Demand and Supply

When aggregate demand is equal to aggregate supply, the economy is in equilibrium. The equilibrium price level and the equilibrium real GDP are determined by the point at which the AD curve and AS curve intersect.

Shifts in AD and AS cause the equilibrium level of real GDP and the price level to change in the following ways:

- An increase in AD increases the price level and increases real GDP. There is a trade-off between higher inflation and higher GDP. During a recession, real GDP increases more than inflation. If the economy is near full employment, the price level will increase more than real GDP. Stimulating AD has different effects depending on whether the economy is in a recession or near full employment.
- A decrease in AD will decrease the price level and decrease real GDP. If the economy is in full employment, inflation will decrease more than real GDP. If there is a recession, real GDP will decrease more than the price level.
- An increase in AS decreases the price level and increases real GDP. This is the best of all possible situations — a lower price level, higher output, and less unemployment.
- A decrease in AS increases the price level and decreases real GDP. This is the worst of all possible situations — a higher price level, lower output, and higher unemployment.

For each of the four events below, make additions that illustrate the change on the diagram. Then indicate the response in terms of shifts in or movements along the AS curve or AD curve and the effect on real GDP and the price level in the short run. Indicate ***shifts*** in the curve by **S** and ***movements*** along the curve by **A**. Indicate the changes in the price level, unemployment and real GDP with (+) for an increase and (-) for a decrease.

	1. Increase in labor productivity due to technological change	2. Increase in the price of inputs used by many firms	3. Boom in investment, assuming some unemployed resources are available	4. A major reduction in investment spending
				
AD curve				
AS curve				
Real GDP				
Price level				
Unemployment				