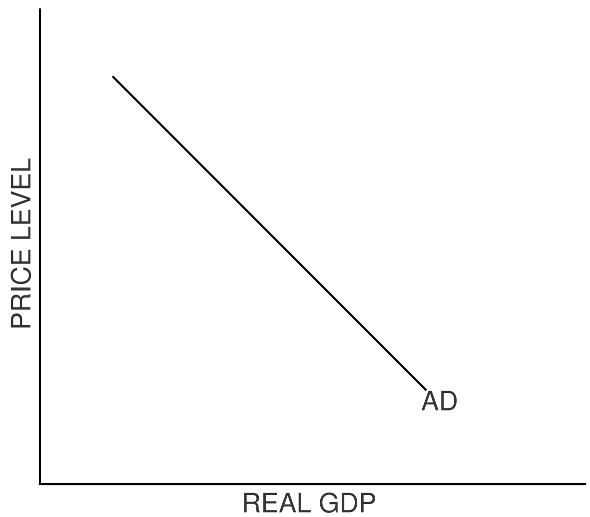
# *An Introduction to Aggregate Demand*

## Part A
## Why Is the Aggregate Demand Curve Downward Sloping?

Figure 23.1
**Aggregate Demand Curve**




1. According to the AD curve, what is the relationship between the price level and real GDP?

2. Explain how each of the following effects helps explain why the AD curve is downward sloping.

   (A) Interest rate effect

   (B) Wealth effect or real-balance effect

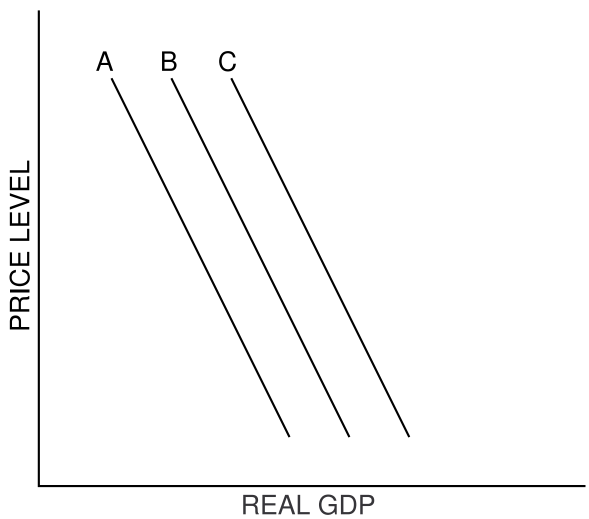
   (C) Net export effect

Activity written by John Morton, National Council on Economic Education, New York, N.Y.

3. In what ways do the reasons that explain the downward slope of the AD curve differ from the reasons that explain the downward slope of the demand curve for a single product?

## Part B
## What Shifts the Aggregate Demand Curve?

Figure 23.2
**Shifts in Aggregate Demand**




4. Using Figure 23.2, determine whether each situation below will cause an increase, decrease or no change in AD. Always start at curve B. If the situation would cause an increase in AD, draw an up arrow in column 1. If it causes a decrease, draw a down arrow. If there is no change, write NC. For each situation that causes a change in aggregate demand, write the letter of the new demand curve in column 2. Move only one curve.

| Situation | 1. Change in AD | 2. New AD Curve |
|---|---|---|
| (A) Congress cuts taxes. | | |
| (B) Autonomous investment spending decreased. | | |
| (C) Government spending to increase next fiscal year; president promises no increase in taxes. | | |
| (D) Survey shows consumer confidence jumps. | | |
| (E) Stock market collapses; investors lose billions. | | |
| (F) Productivity rises for fourth straight year. | | |
| (G) President cuts defense spending by 20 percent; no increase in domestic spending. | | |

**Aggregate Supply Worksheet**

Aggregate supply is the total amount of goods and services that all industries in the economy will produce at every given price level.

- In contrast to Aggregate demand we distinguish between the short-run and long run with aggregate supply.

**Objective 1 & 2: Define short-run aggregate supply (SRAS). Illustrate SRAS.**

**Short-run aggregate supply (SRAS)-**

**Objective 3: Explain the causes of shifts in SRAS.**

Define “supply-side shocks”-

↓costs will cause SRAS to:
↑ costs will cause SRAS to:

Typical examples of supply-side shocks.

| | |
|---|---|
| ∆s in wage rates | |
| ∆s in costs of raw materials | |
| ∆s in the price of imports | |
| ∆s in government indirect taxes or subsidies | |

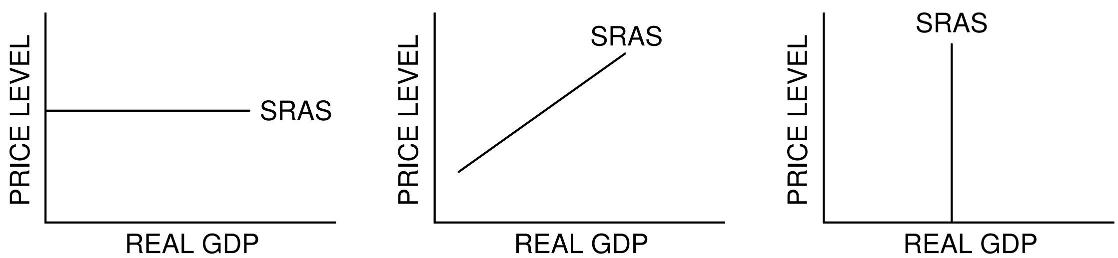
<u>Short-run macroeconomic equilibrium</u>

**Short-run macroeconomic equilibrium occurs when**:

# *An Introduction to Short-Run Aggregate Supply*

**Part A**
**Why Can the Aggregate Supply Curve Have Three Different Shapes?**

Figure 24.1
**Possible Shapes of Aggregate Supply Curve**




1. Under what conditions would an economy have a horizontal SRAS curve?

2. Under what conditions would an economy have a vertical SRAS curve?

3. Under what conditions would an economy have a positively sloped SRAS curve?

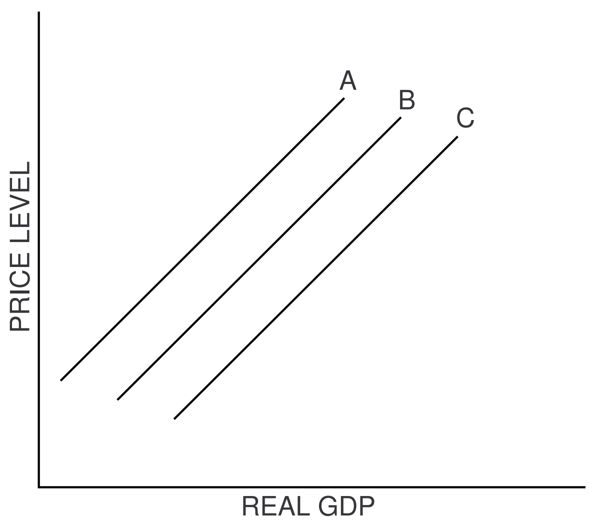
Activity written by John Morton, National Council on Economic Education, New York, N.Y.

4. Assume AD increased. What would be the effect on real GDP and the price level if the economy had a horizontal SRAS curve? A positively sloped SRAS curve? A vertical SRAS curve?

5. What range of the SRAS curve do you think the economy is in today? Explain.

## Part B
## What Shifts the Short-Run Aggregate Supply Curve?

Figure 24.2
**Shifts in Short-Run Aggregate Supply**




6. Using Figure 24.2, determine whether each situation below will cause an increase, decrease or no change in short-run aggregate supply (SRAS). Always start at curve B. If the situation would cause an increase in SRAS, draw an up arrow in column 1. If it causes a decrease, draw a down arrow. If there is no change, write NC. For each situation that causes a change in SRAS, write the letter of the new curve in column 2. Move only one curve.

| Situation | 1. Change in SRAS | 2. New SRAS Curve |
|---|---|---|
| (A) Unions grow more aggressive; wage rates increase. | | |
| (B) OPEC successfully increases oil prices. | | |
| (C) Labor productivity increases dramatically. | | |
| (D) Giant natural gas discovery decreases energy prices. | | |
| (E) Computer technology brings new efficiency to industry. | | |
| (F) Government spending increases. | | |
| (G) Cuts in tax rates increase incentives to save. | | |
| (H) Low birth rate will decrease the labor force in future. | | |
| (I) Research shows that improved schools have increased the skills of American workers and managers. | | |