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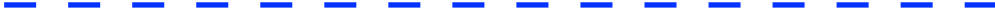
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GDP_o

P_1



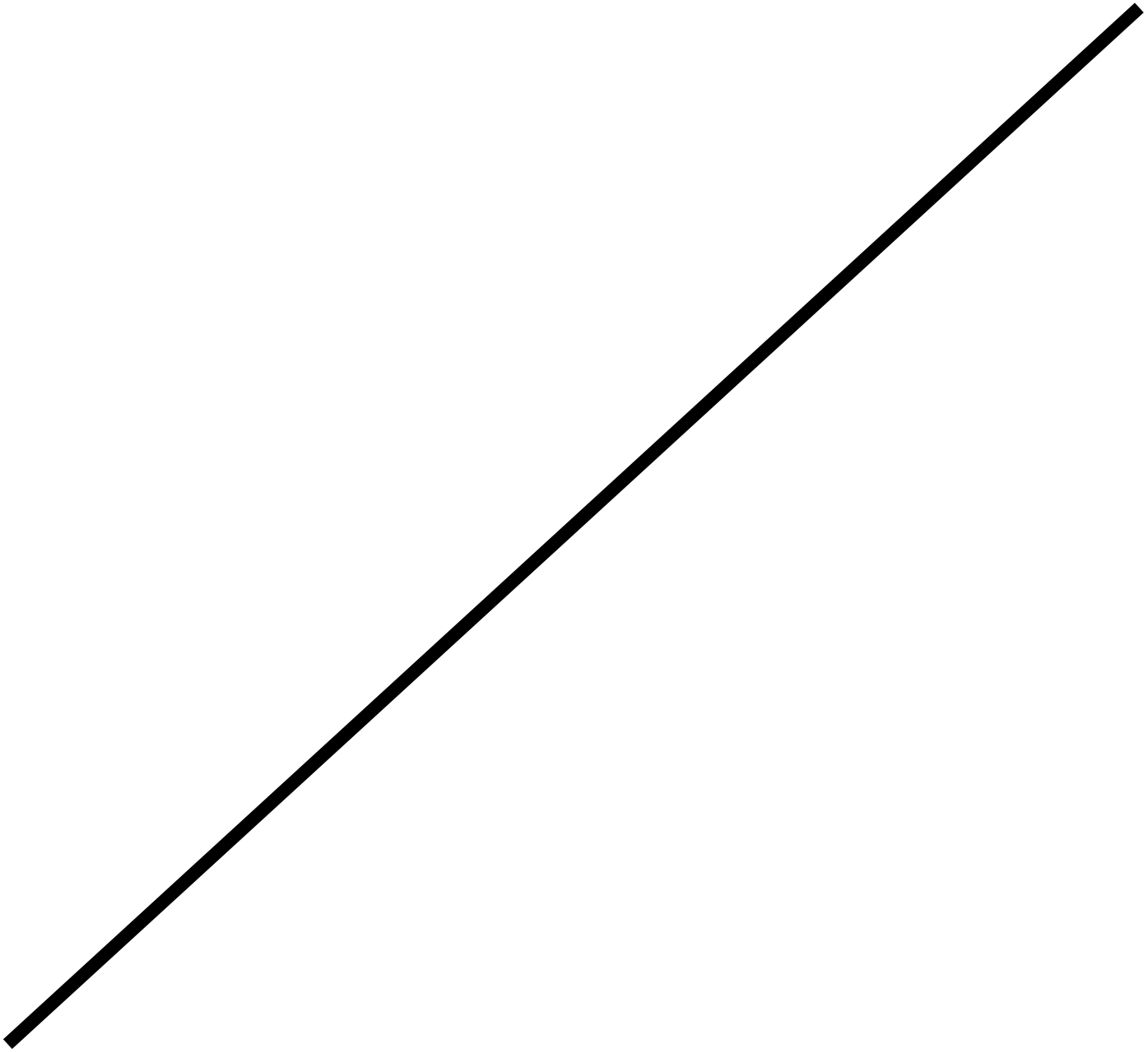
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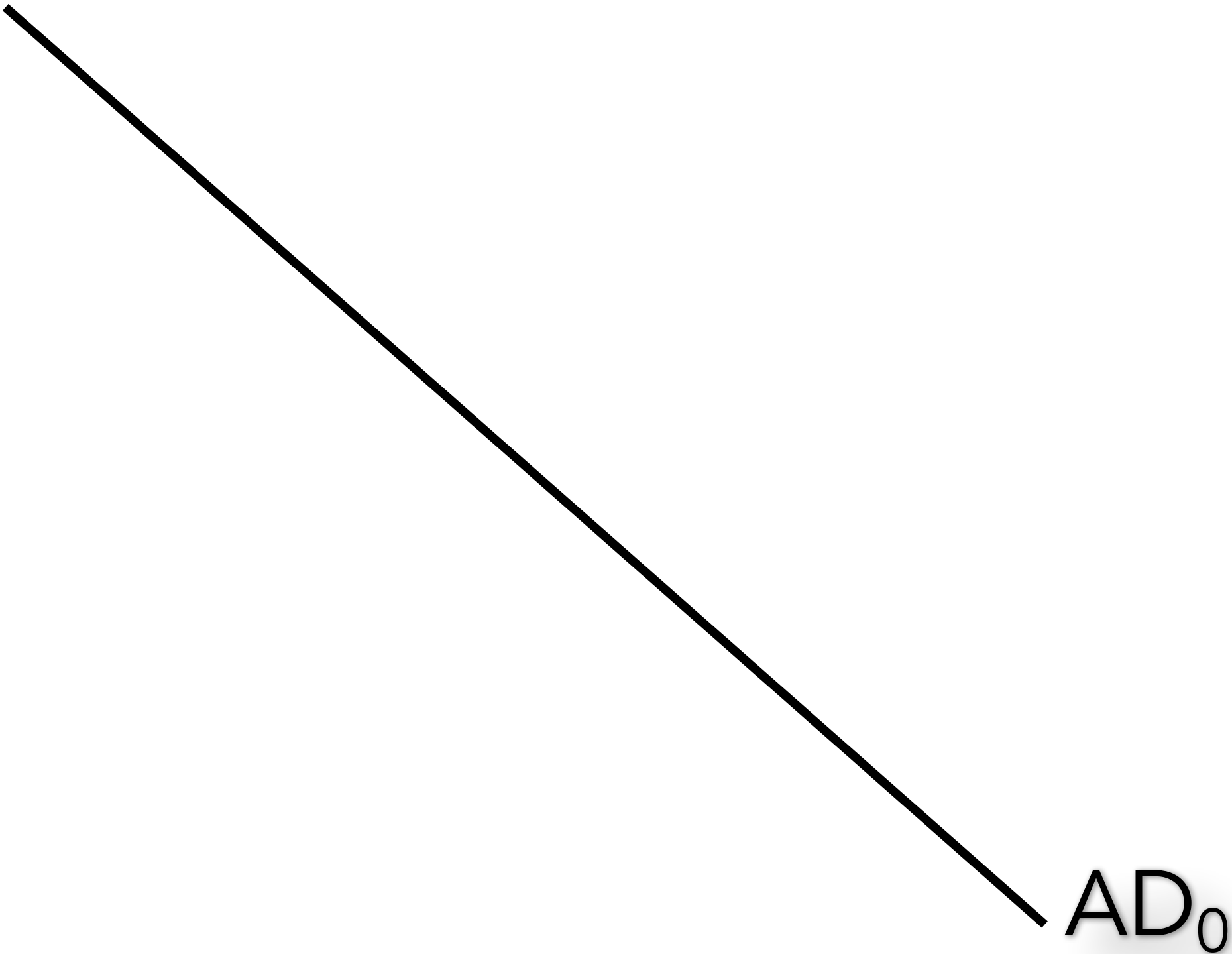
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Aggregate Supply
when prices = P_o

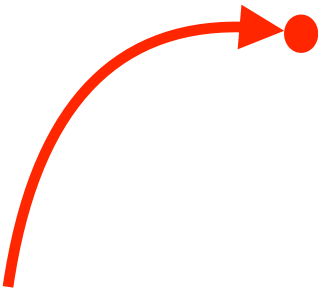


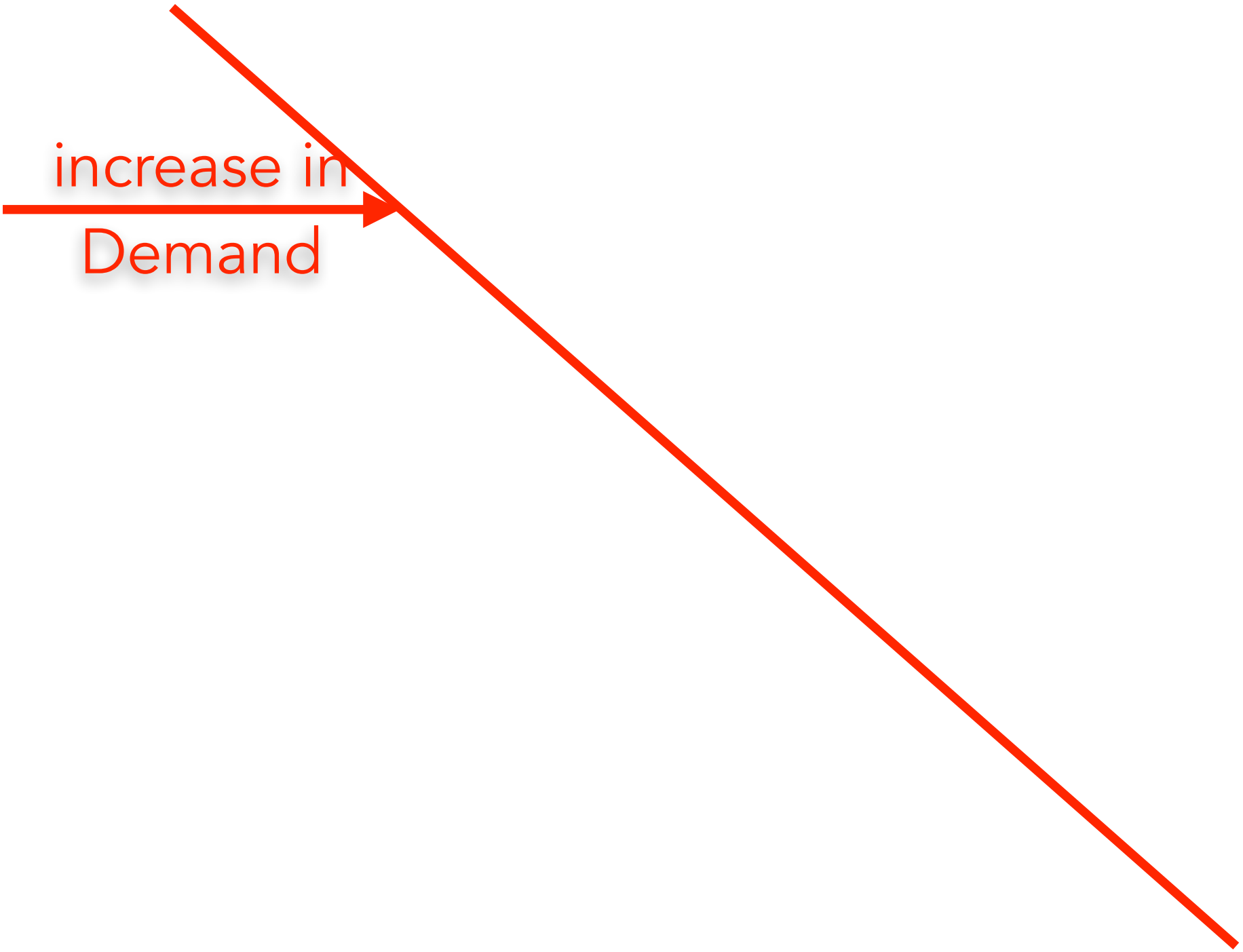
Firms increase
production and prices











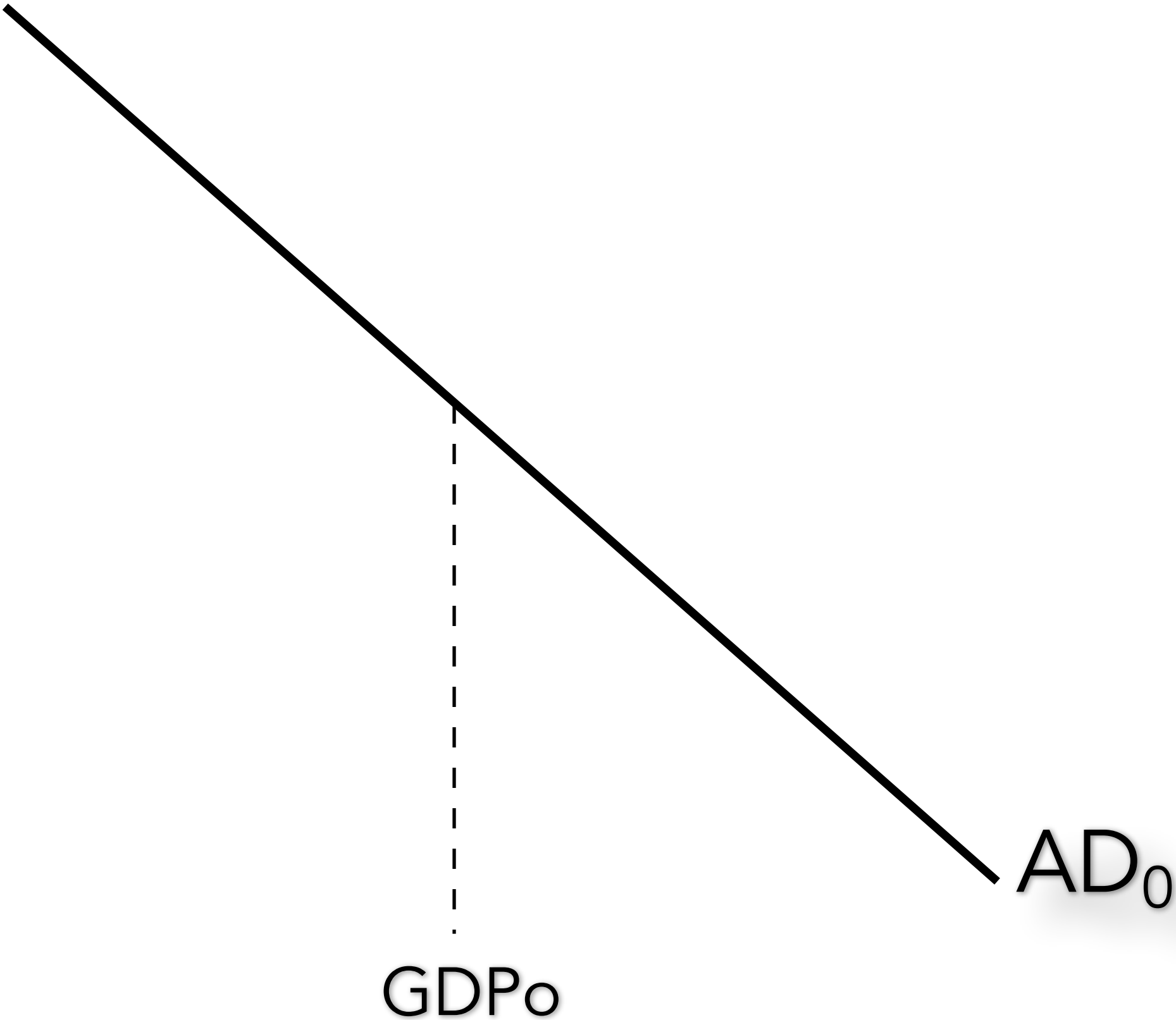
AD₁





Aggregate Demand
when prices = P_0

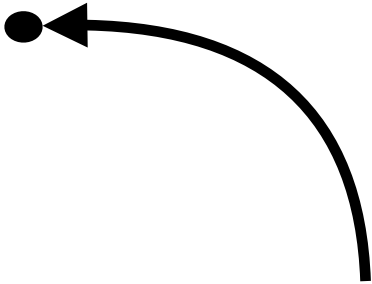
GDP₁



Inventories
Drop



Increase in GDP is
smaller than the
increase in AD



As prices rise
AD decrease

Price Level
(CPI)



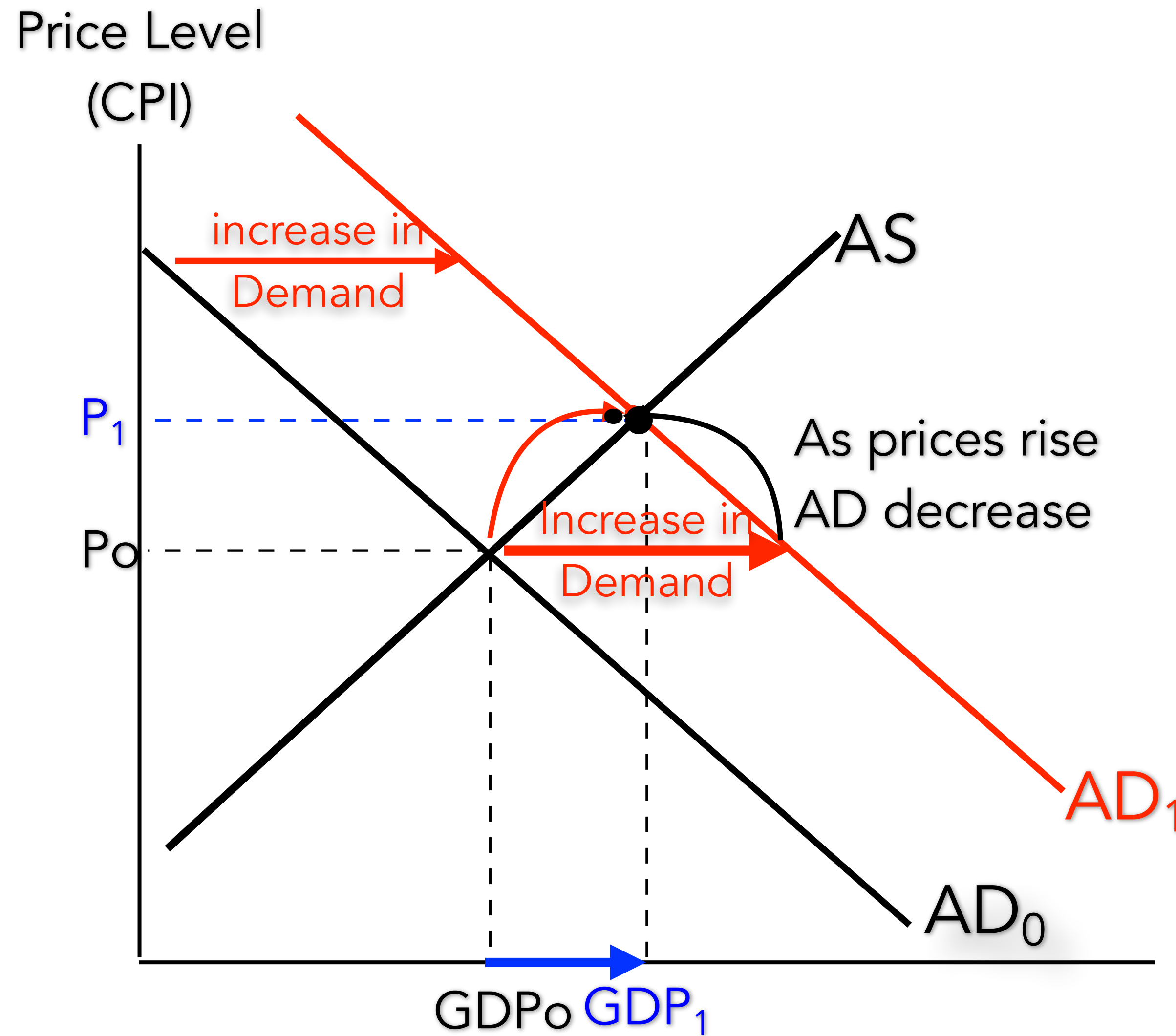
The Effect of an Increase in Demand

Increase in



Demand

The Effect of an Increase in Demand



Firms increase production **and** prices

Increase in GDP is **smaller** than **the** increase in AD

The Effect of an Decrease in Demand

