Short Run

Aggregate Supply

Price Level

GDP Produced in the short run (while wages are constant)

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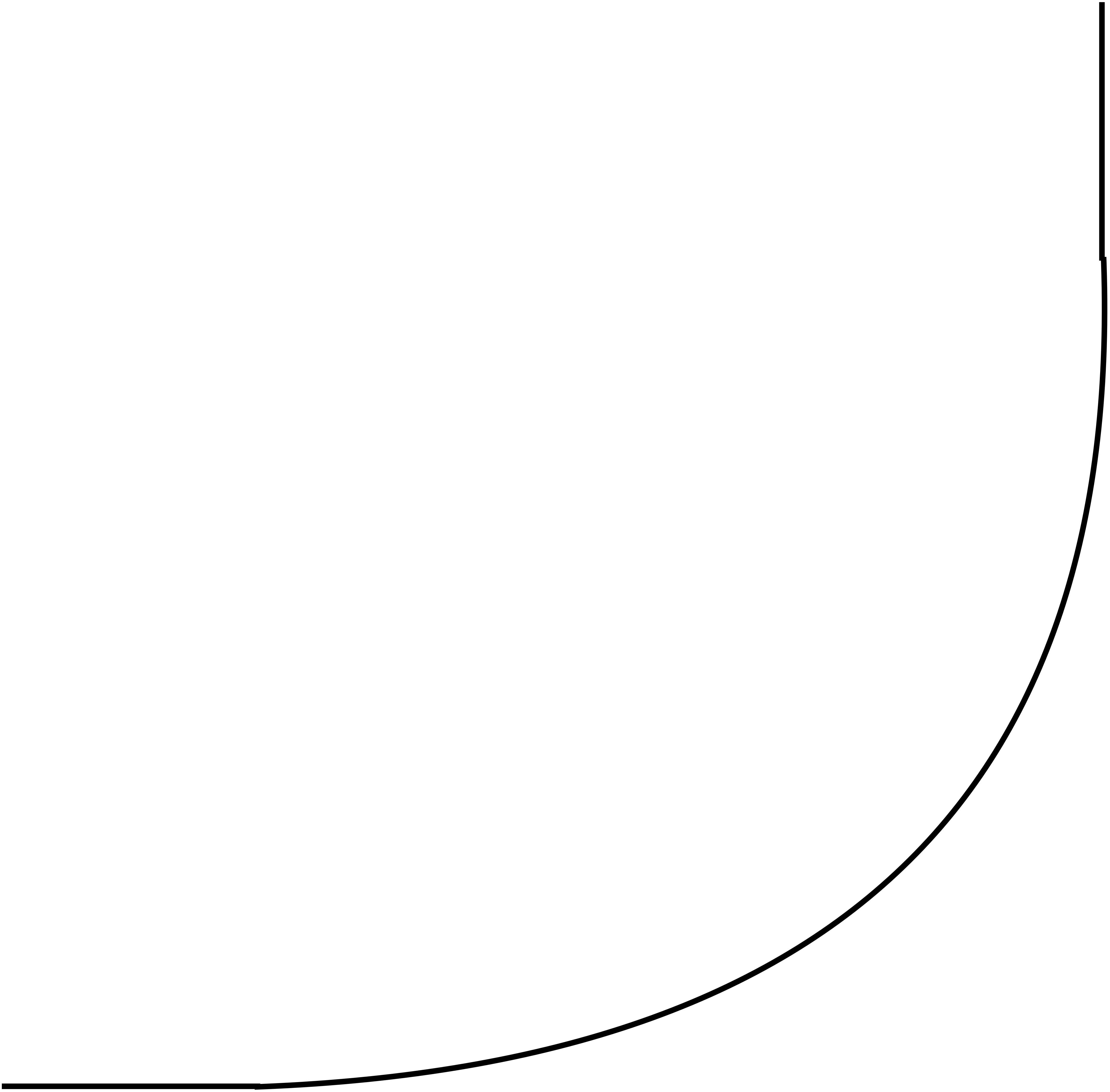
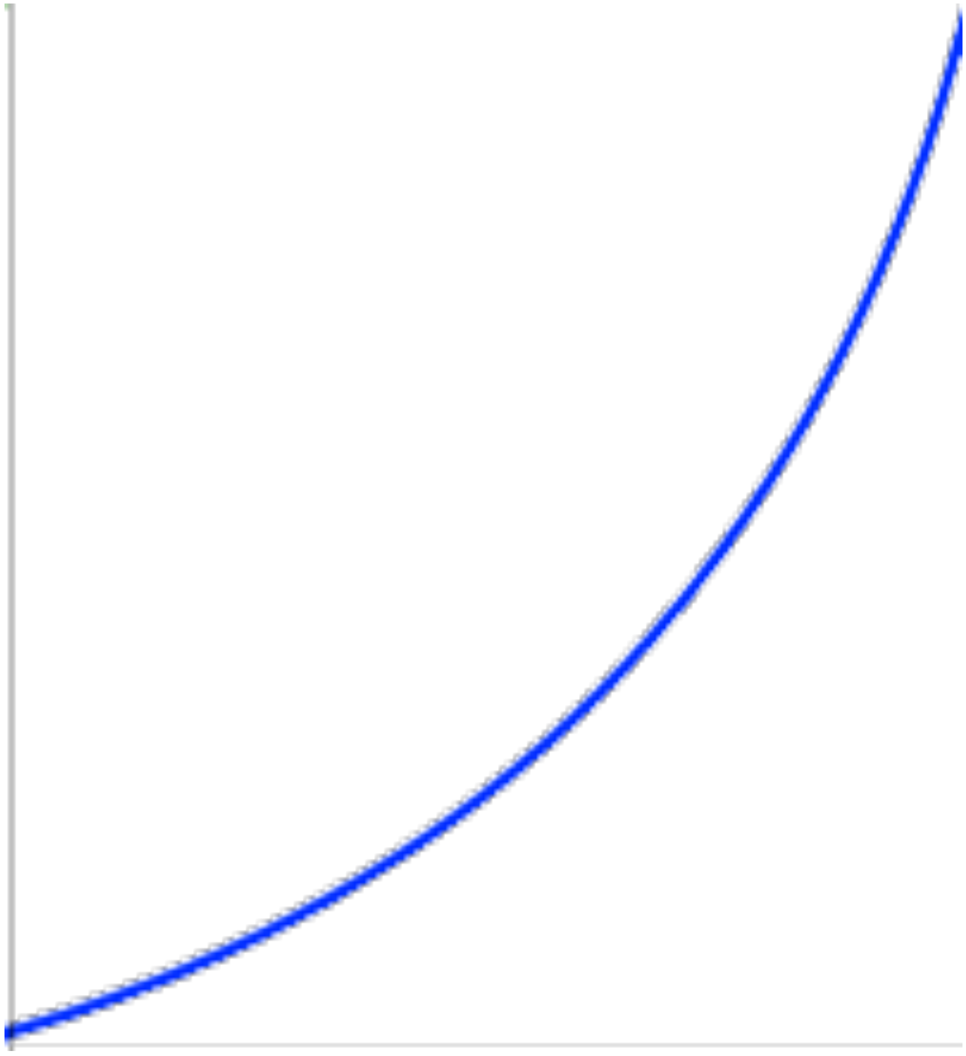


At Potential GDP

Very low GDP
(a Recession)

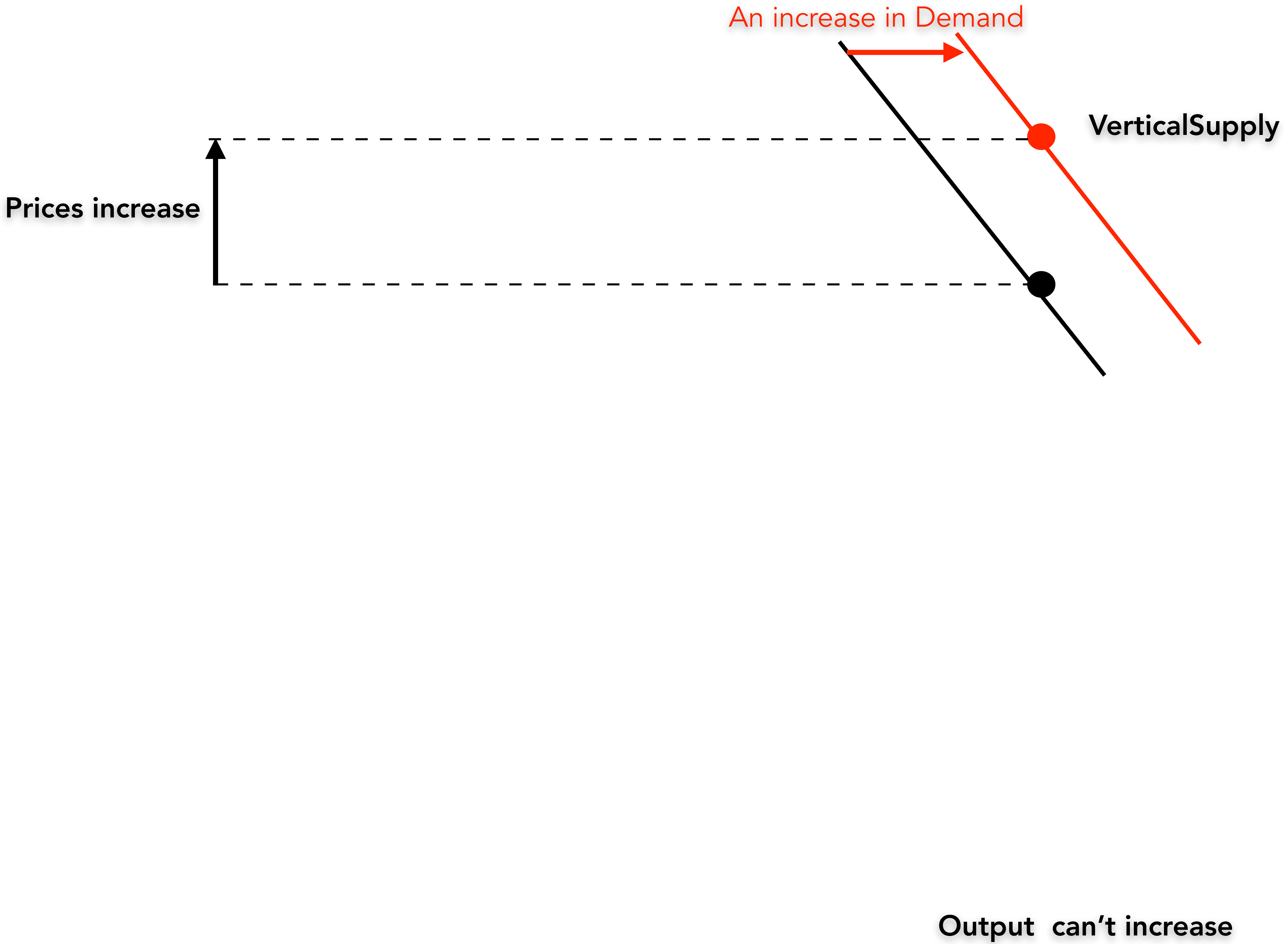


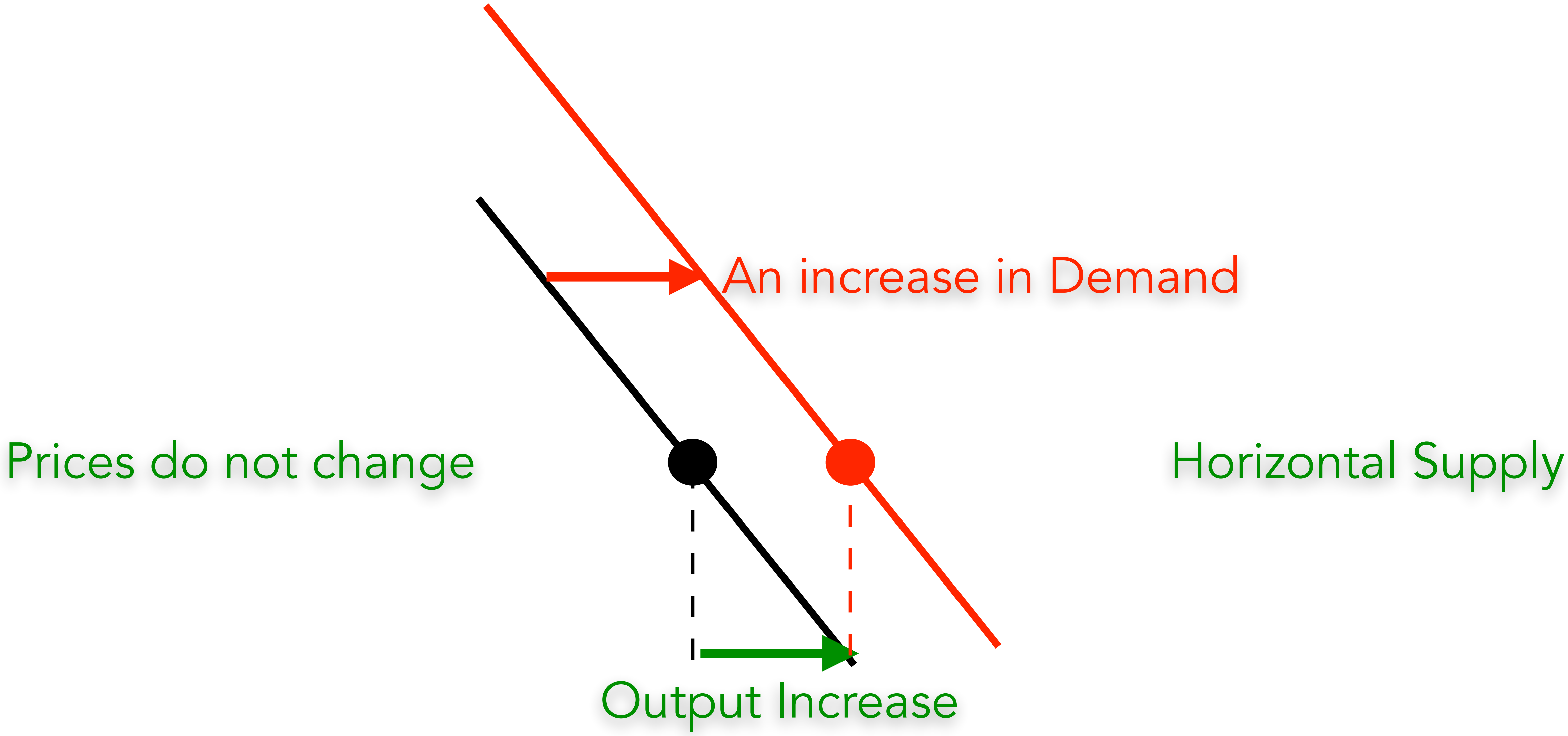
Below Potential GDP

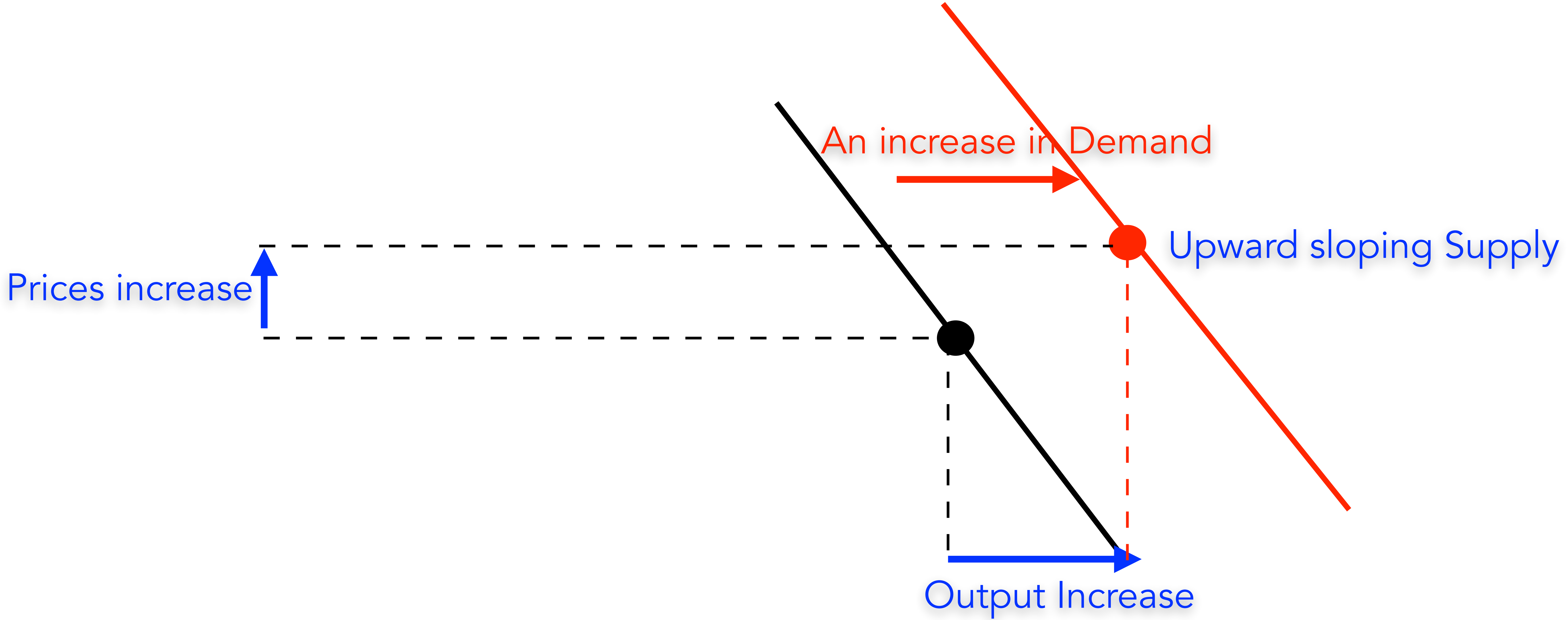
Supply is vertical: firms increase prices but can't increase output

Supply is upward sloping: firms raise both prices and output

How firms react to an increase in Aggregate Demand depends on where the Economy is…


An increase in Demand
VerticalSupply
Prices increase
Output can't increase

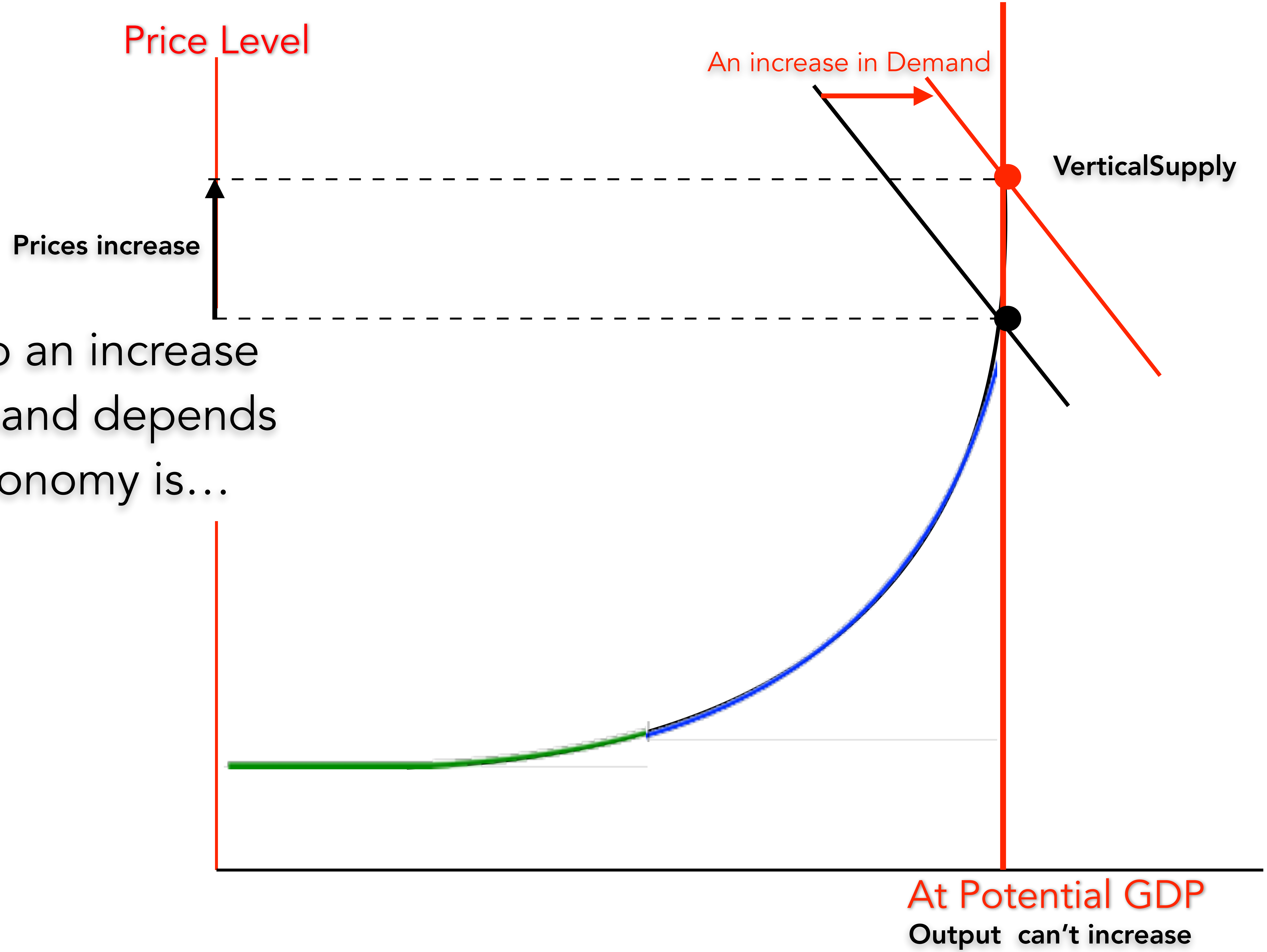

An increase in Demand
Prices do not change
Horizontal Supply
Output Increase


An increase in Demand
Upward sloping Supply
Prices increase
Output Increase

Supply is horizontal: firms increase output but will not raise prices

$SRAS(Wages_{fixed})$

How firms react to an increase in Aggregate Demand depends on where the Economy is…



MPC = 0.75
An increase in G
$\Delta G = +70$
45
AE_1
AE_0
Price Level (CPI)
AE_1
$\Delta AE=280$
$\Delta AD = 280$
ΔG
AE_0
$\Delta Y=\Delta G\left(\frac{1}{1-MPC}\right)$
$\Delta Y = 280$
Y_0
Y_1
Po
AD_0
GDPo