

Aggregate Supply

Chapter 11-3 Aggregate Supply

Aggregate Supply

- The **aggregate supply curve** shows the relationship between the aggregate price level and the quantity of aggregate output.

Aggregate Supply Curve

- **Aggregate Supply** is the amount of real GDP that will be made available by sellers at various price levels.
- Aggregate Supply looks different in the **Long Run** and the **Short Run**:
 - **In the Long Run**, classical economists assume the economy operates at full employment (maximum output), independent of the price level.
 - **In the Short Run**, businesses will increase supply if the price level increases.

Positive Relationship

- There is a positive relationship in the short run between price level and the quantity of aggregate output supplied.

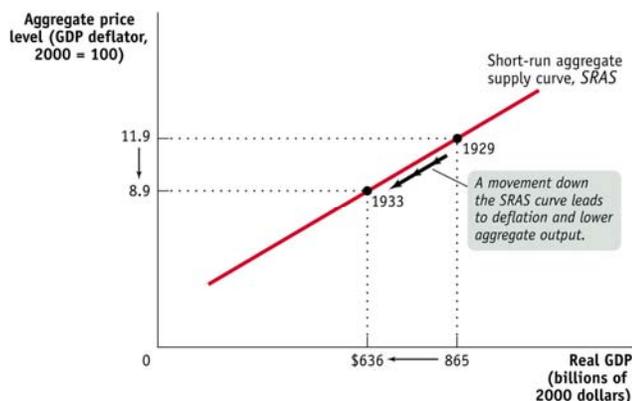
The SAS is positively sloped because:

- Auction markets
 - Prices are determined by demand and supply
 - \uparrow prices \rightarrow \uparrow profits \rightarrow \uparrow quantity supplied
- Posted-price markets
 - Prices are set by producers and don't often change
 - Firms respond to changes in demand by adjusting output instead of prices

Sticky Nominal Wages

- The **short-run aggregate supply curve** is upward-sloping because nominal wages are sticky in the short run:
 - a higher aggregate price level leads to higher profits and increased aggregate output in the short run.
- The **nominal wage** is the dollar amount of the wage paid.

The Short-Run Aggregate Supply Curve



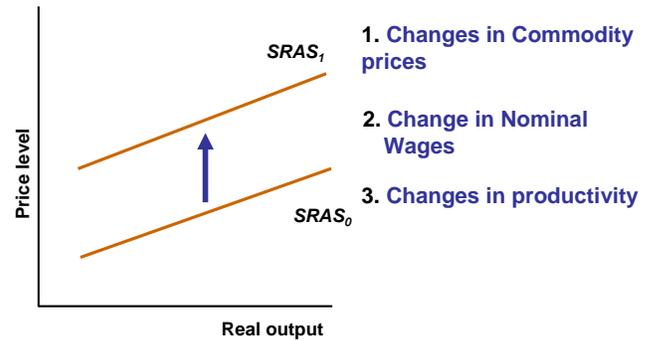
Movement Vs. Shift

- Movements are caused by change in Aggregate Price Levels
- Shift in SRAS is caused by:

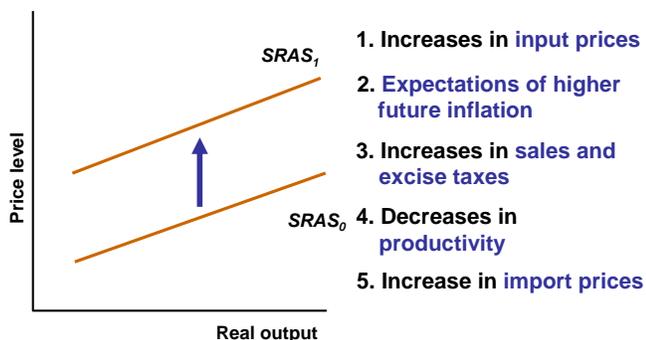
Shift in SRAS

- Changes in
 - commodity prices,
 - nominal wages, and
 - productivity
- lead to changes in producers' profits and shift the short-run aggregate supply curve

Textbook lists 3 shift factors



The SRAS shifts upward for 5 reasons (outside the text)



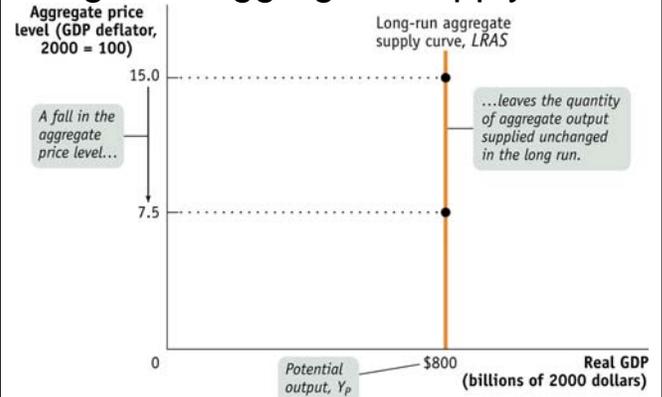
LRAS

- The **long-run aggregate supply curve** shows the relationship between the aggregate price level and the quantity of aggregate output supplied that would exist if all prices, including nominal wages, were fully flexible

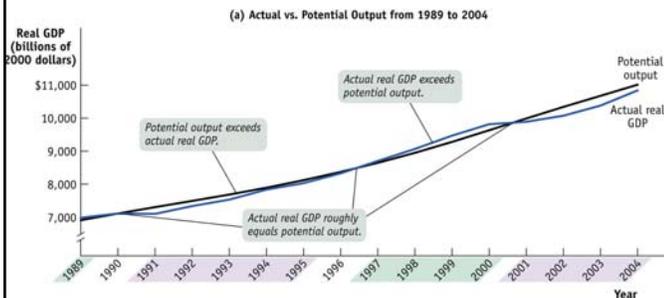
A Range for Potential Output and the LAS Curve

- The position of the long-run aggregate supply curve is determined by potential output.
- **Potential output** – the amount of goods and services an economy can produce when both labor and capital are fully employed.

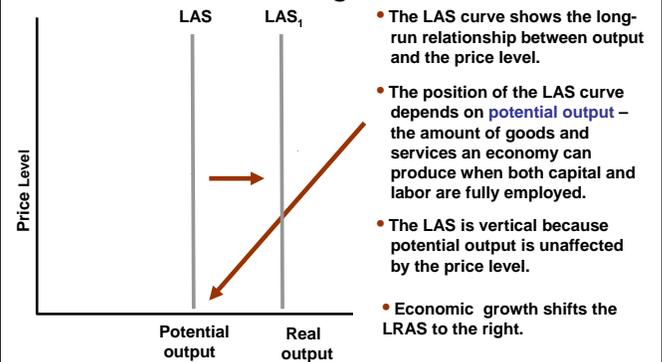
Long-Run Aggregate Supply Curve



Actual and Potential Output

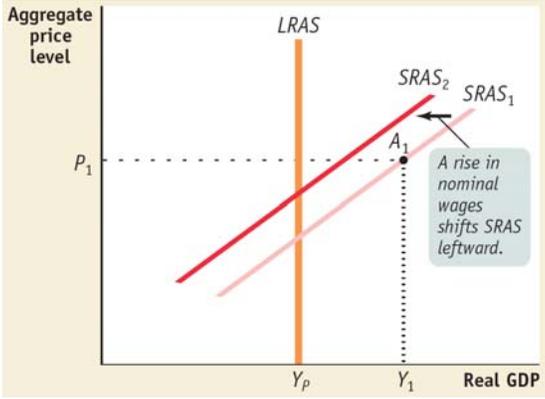


Economic Growth Shifts the LRAS Curve Rightward



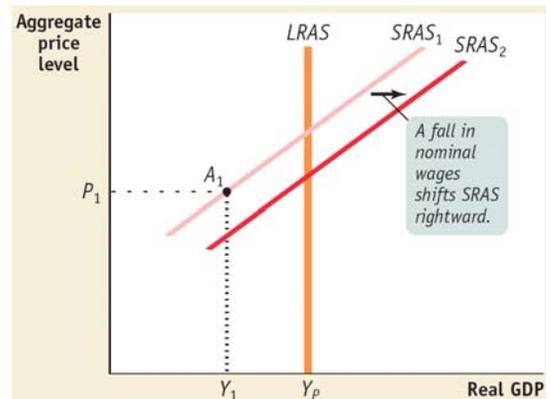
From the Short Run to the Long Run

Leftward Shift of the Short-run Aggregate Supply Curve

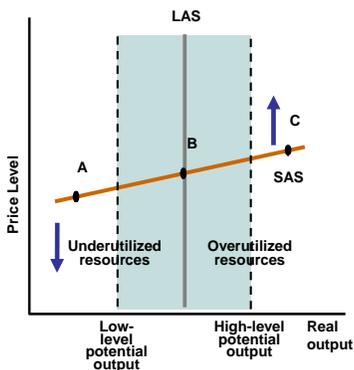


From the Short Run to the Long Run

Rightward Shift of the Short-run Aggregate Supply Curve



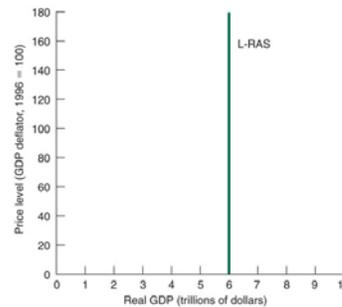
LAS Curve



- Estimating potential output is inexact, so it is assumed to be the middle of a range bounded by a high level of potential output and a low level of potential output.
- The relationship between potential and actual output – where the economy is on SAS – determines shifts in SAS.
- When resources are over-utilized (point C), factor prices may be bid up and the SAS shifts up.
- When resources are under-utilized (point A), factor prices may decrease and SAS shifts down.
- When LAS = SAS (point B), there is no pressure for prices to rise or fall.

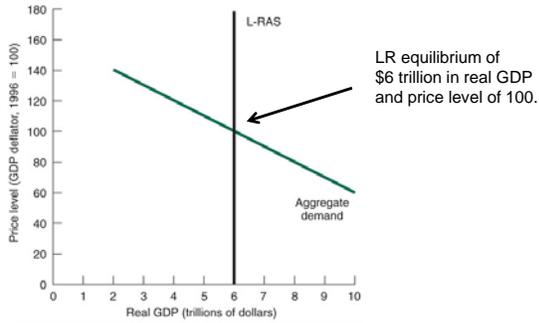
Long-Run Aggregate Supply Curve

- LRAS is vertical line at full employment level of GDP (regardless of price level).



Real GDP = \$6 trillion at every point on LRAS.

Long-Run Macroeconomic Equilibrium



Supply Creates Its Own Demand!

Short-Run Aggregate Supply Curve

- SRAS is relatively flat at low levels of output, and gradually approaches vertical.

