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*](https://example.com) 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

- 1. Changes in Commodity prices
- 2. Change in Nominal Wages
- 3. Changes in productivity

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

- 1. Increases in input prices
- 2. Expectations of higher future inflation
- 3. Increases in sales and excise taxes
- 4. Decreases in productivity
- 5. Increase in import prices

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.
From the Short Run to the Long Run

Leftward Shift of the Short-run Aggregate Supply Curve

Rightward Shift of the Short-run Aggregate Supply 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.

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

Real GDP = $8 trillion at every point on LRAS.
Long-Run Macroeconomic Equilibrium

LR equilibrium of $6 trillion in real GDP and price level of 100.

Short-Run Aggregate Supply Curve

- SRAS is relatively flat at low levels of output, and gradually approaches vertical.
- Beyond full employment GDP, expanding production is more expensive, so firms need large price increase output.
- At low levels of output, firms can easily expand output when prices rise.

Supply Creates Its Own Demand!