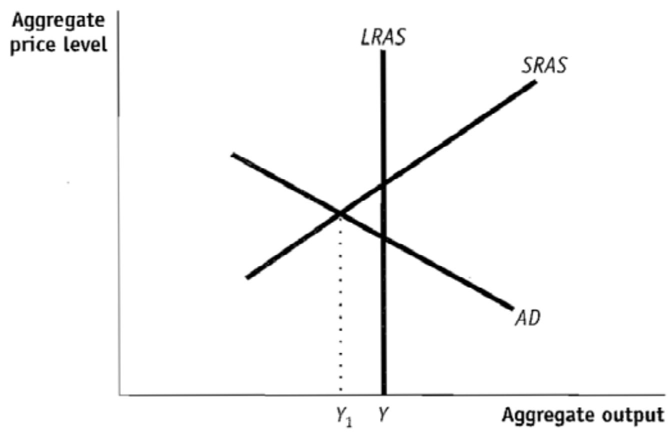
TIP: It is important to distinguish between short-run and long-run *AS*.

In the short run, wages are sticky: this stickiness results in a short-run *AS* curve that is upward sloping. In the long run, wages are fully flexible, leading the economy to always produce its long-run equilibrium at the potential output level of real GDP. This is the output level the economy produces when all wages and prices are fully flexible. In the following graph, the short-run aggregate supply curve is *SRAS*, the aggregate demand curve is *AD*, the long-run aggregate supply curve is *LRAS*, and the potential output level, which represents the long-run equilibrium level of output, is *Y*. The economy in the short run may produce an aggregate output level that is greater than or less than the potential level of output *Y*. Figure 10.1, which follows, illustrates a situation where the short-run level of aggregate output Y_1 is less than the long-run level of output labeled *Y*.

Figure 10.1



TIP: It is important to distinguish between a movement along the *AD* or *AS* curve and a shift of the *AD* or *AS* curve.

A change in the aggregate price level causes a movement along either curve (see Figures 10.2a and 10.2b, which follow), while a change in commodity prices, nominal wages, or productivity shifts the *AS* curve, and a change in expectations, wealth, physical capital, fiscal policy, or monetary policy shifts the *AD* curve (see Figures 10.2c and 10.2d,which follow).

Figure 10.2a

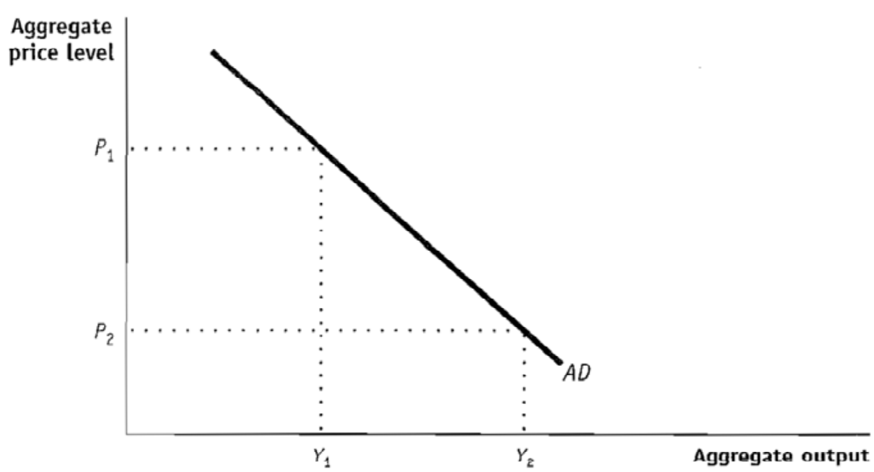


Figure 10.2b

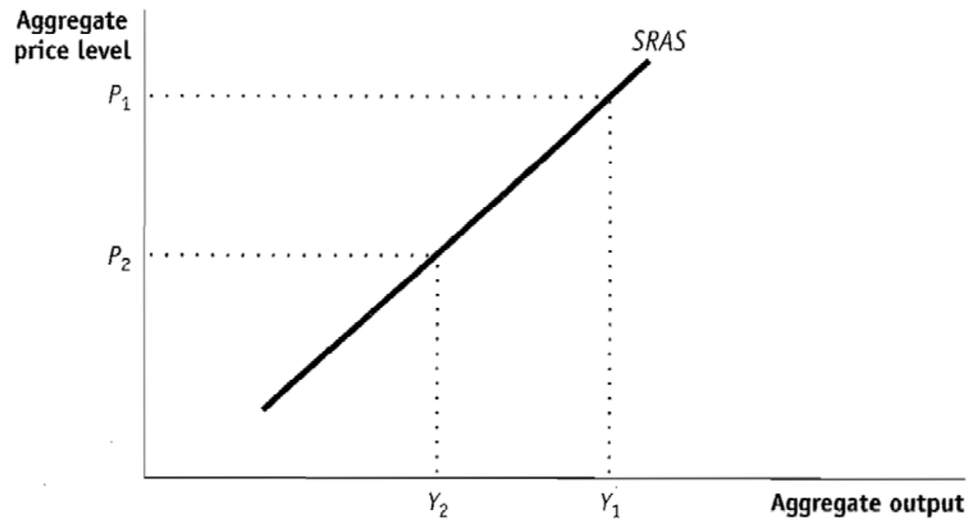


Figure 10.2c

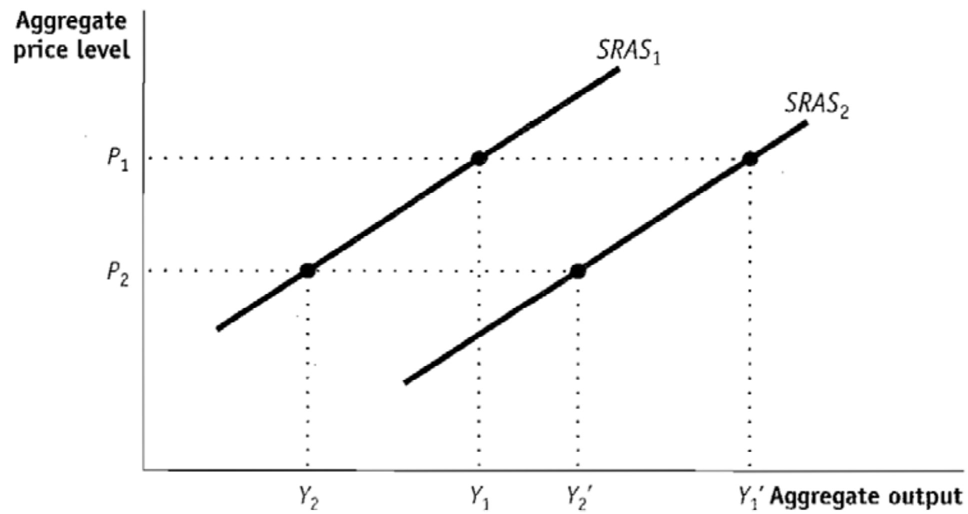
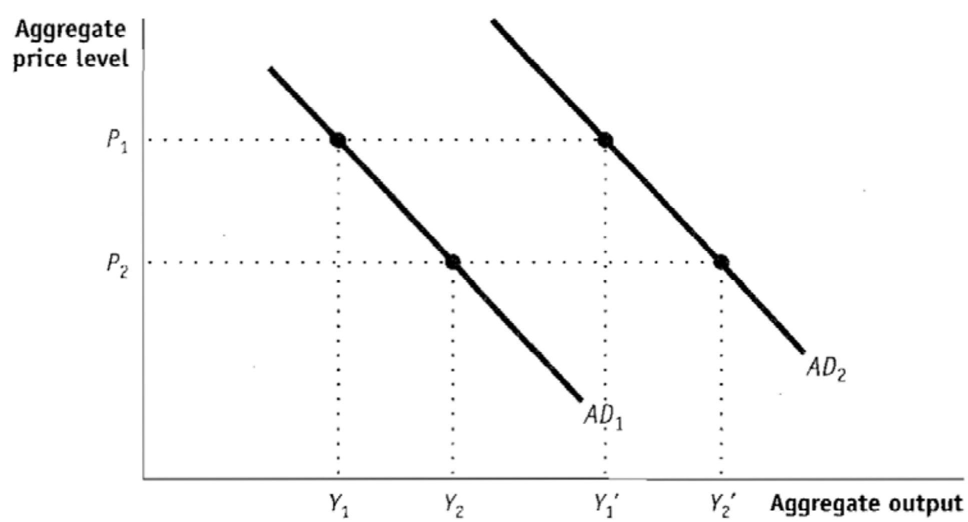


Figure 10.2d



TIP: It is important to know the variables that shift *AS* and *AD*.

The text provides a list and an explanation for the variables that cause either the *AS* or *AD* curves to shift. It is crucial that you know these variables and that you understand the direction the curves shift with changes in these variables. (See the previous tip for a quick review of these variables.)

TIP: Changes in commodity prices have large impacts on production costs.

Understanding the impact of commodity prices on the *AS* curve will enhance your understanding of the impact of supply shocks in the *AS-AD* model.

TIP: The long-run *AS* curve is vertical, and its position represents the economy's potential output when all resources are fully employed.

It is important to understand why the long-run *AS* curve is vertical as well as the relevance of its position on the horizontal axis. Over time if an economy experiences economic growth the long-run *AS* curve shifts to the right, indicating the economy's potential output has increased.

TIP: It is important to understand why *AD* is downward sloping.

You need to review the wealth and interest rate effects and how they explain the inverse relationship between the aggregate price level and aggregate output.

TIP: It is important to understand the difference between short-run and long-run macroeconomic equilibrium and the relationship between these equilibria.

In long-run macroeconomic equilibrium, aggregate output equals potential output and the economy's *AD* equals both its short-run and long-run *AS* (see Figure 10.3a, which follows). In short-run macroeconomic equilibrium aggregate, output need not equal potential output, but the economy's *AD* must equal the short-run *AS*. Figure 10.3b, which follows, illustrates a short-run equilibrium with an inflationary gap where actual production, Y_2, is greater than *Y*. Figure 10.3c, which follows, illustrates a short-run equilibrium with a recessionary gap where actual production, Y_2, is less than *Y*. Over time the short-run *AS* adjusts through changes in the nominal wage to equate *AD* with the long-run *AS*.

Figure 10.3a

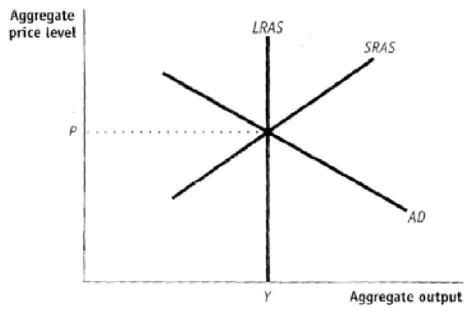


Figure 10.3b

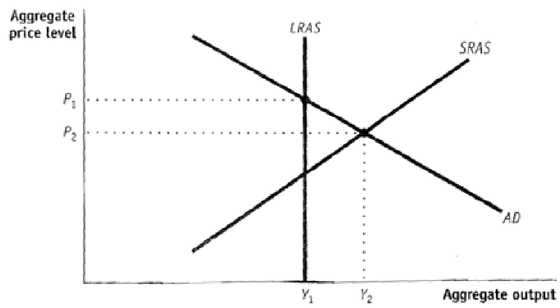
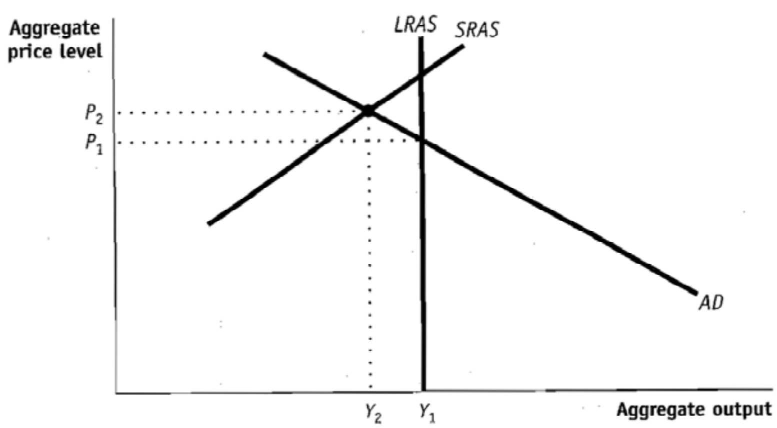


Figure 10.3c



TIP: The multiplier concept is important to understand.

This chapter introduces the multiplier and uses it to illustrate the idea that a small change in one variable can lead to a big change in some other variable. The multiplier concept is an important idea in your study of macroeconomics.