MODULE 19
THE AD/AS MODEL

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AP Macroeconomics

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## THE AD/AS MODEL

- The equilibrium of AD & AS determines current output (GDP_R) and the price level (PL)
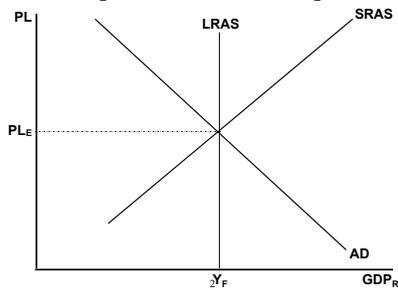
FULL EMPLOYMENT

- Full Employment equilibrium exists where AD intersects SRAS & LRAS at the same point.
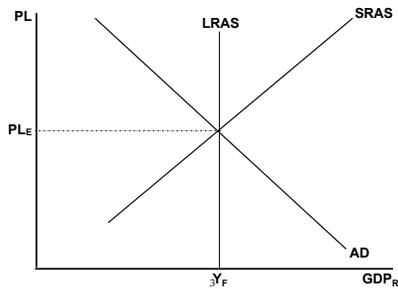
RECESSIONARY GAP

- A recessionary gap exists when equilibrium occurs below full employment output.
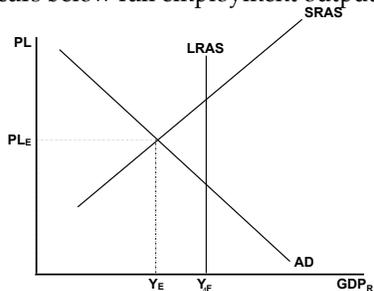
INFLATIONARY GAP

- An inflationary gap exists when equilibrium occurs beyond full employment output.

PL — LRAS — SRAS

PL_E

AD

Y_F Y_E GDP_R
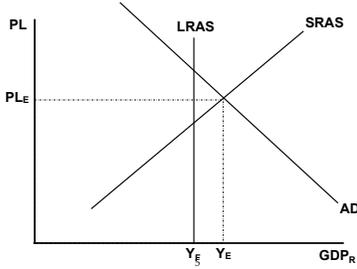
CHANGES IN AD (Δ AD)

- Δ Consumption (C)
  - $C\uparrow$.: AD $\rightarrow$.: $GDP_R\uparrow$ & PL$\uparrow$.: u%$\downarrow$ & π%$\uparrow$
  - $C\downarrow$.: AD $\leftarrow$.: $GDP_R\downarrow$ & PL$\downarrow$.: u%$\uparrow$ & π%$\downarrow$
- Δ Gross Private Investment (I_G)
  - $I_G\uparrow$.: AD $\rightarrow$.: $GDP_R\uparrow$ & PL$\uparrow$.: u%$\downarrow$ & π%$\uparrow$
  - $I_G\downarrow$.: AD $\leftarrow$.: $GDP_R\downarrow$ & PL$\downarrow$.: u%$\uparrow$ & π%$\downarrow$
- Δ Government Spending (G)
  - $G\uparrow$.: AD $\rightarrow$.: $GDP_R\uparrow$ & PL$\uparrow$.: u%$\downarrow$ & π%$\uparrow$
  - $G\downarrow$.: AD $\leftarrow$.: $GDP_R\downarrow$ & PL$\downarrow$.: u%$\uparrow$ & π%$\downarrow$
- Δ Net Exports (X_N)
  - $X_N\uparrow$.: AD $\rightarrow$.: $GDP_R\uparrow$ & PL$\uparrow$.: u%$\downarrow$ & π%$\uparrow$
  - $X_N\downarrow$.: AD $\leftarrow$.: $GDP_R\downarrow$ & PL$\downarrow$.: u%$\uparrow$ & π%$\downarrow$
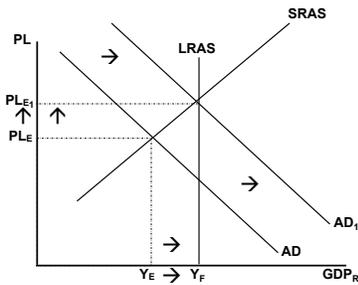
INCREASE IN AD

$C\uparrow$, $I_G\uparrow$, $G\uparrow$ and/or $X_N\uparrow$.: AD $\rightarrow$.: $GDP_R\uparrow$ & PL$\uparrow$.: u%$\downarrow$ & π%$\uparrow$

DECREASE IN AD
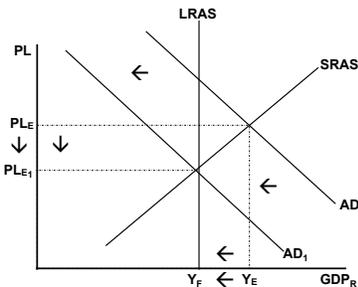
$C\downarrow$, $I_G\downarrow$, $G\downarrow$ and/or $X_N\downarrow$.: AD $\leftarrow$.: $GDP_R\downarrow$ & PL$\downarrow$.: u%$\uparrow$ & π%$\downarrow$

CHANGES IN SRAS (Δ SRAS)

- Δ Input Prices
  - Input Prices↓ .: SRAS → .: GDP_R↑ & PL↓ .: u%↓ & π%↓
  - Input Prices↑ .: SRAS ← .: GDP_R↓ & PL ↑ .: u%↑ & π%↑
- Δ Productivity
  - Productivity↑ .: SRAS → .: GDP_R↑ & PL↓ .: u%↓ & π%↓
  - Productivity↓ .: SRAS ← .: GDP_R↓ & PL ↑ .: u%↑ & π%↑
- Δ Legal-Institutional Environment
  - Deregulation .: SRAS → .: GDP_R↑ & PL↓ .: u%↓ & π%↓
  - Regulation .: SRAS ← .: GDP_R↓ & PL ↑ .: u%↑ & π%↑

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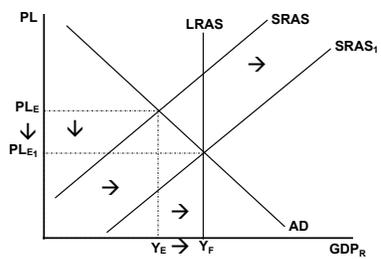
INCREASE IN SRAS

Input Prices↓, Productivity↑, and/or Deregulation
.: SRAS → .: GDP_R↑ & PL↓ .: u%↓ & π%↓

DECREASE IN SRAS
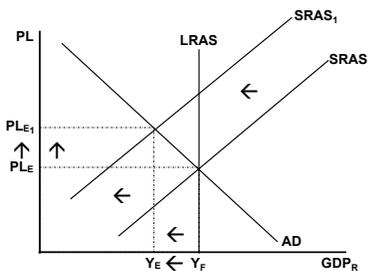
Input Prices↑, Productivity↓, and/or Regulation
.: SRAS ← .: GDP_R↓ & PL↑ .: u%↑ & π%↑

AD/AS SUMMARY

- ΔC, ΔI_G, ΔG, and/or $\Delta X_N = \Delta$ AD
  - AD → .: GDP_R↑ & PL↑ .: u%↓ & π%↑
  - AD ← .: GDP_R↓ & PL↓ .: u%↑ & π%↓
- Δ Input Prices, Δ Productivity, and/or Δ Regulation = Δ SRAS
  - SRAS → .: GDP_R↑ & PL↓ .: u%↓ & π%↓
  - SRAS ← .: GDP_R↓ & PL ↑ .: u%↑ & π%↑

The AD/AS Model is the most important graph in AP Macroeconomics.

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