18.1 Macroeconomic Equilibrium

1. The short run macroeconomic equilibrium is found where the aggregate demand (AD) curve intersects the short run aggregate supply (SRAS) curve.

2. The long run macroeconomic equilibrium is found where the aggregate demand (AD) curve intersects the long run aggregate supply (LRAS) curve. The total quantity of output demanded is equal to the full-employment output level / potential output level in the long run.

3. Define deflationary gap and inflationary gap and show them on diagram (a) and diagram (b) respectively.

Diagram (a)	Diagram (b)
Deflationary gap refers to the difference by which the short run equilibrium output level falls below the full-employment output level.	Inflationary gap refers to the difference by which the short run equilibrium output level is in excess of the full-employment output level.

©Aristo Educational Press Ltd.

18.2 Effects of Changes in Aggregate Demand on the Equilibrium Output and Price Levels

4. Suppose an economy is initially at the long run equilibrium. If aggregate demand increases, how would the price and output levels change in the short run and the long run? Explain your answer with the aid of the following diagram.

- When there is an increase in aggregate demand, the AD curve shifts to the *(left / right)*.
- In the short run, the price level *(increases / decreases)* and the output level *(increases / decreases)*.
- There is *(an inflationary gap / a deflationary gap)*. There is an *(excess demand / excess supply)* in the factor market, resulting in *(an upward / a downward)* pressure on input prices. The cost of production will *(increase / decrease)*. Short run aggregate supply will *(increase / decrease)* and the SRAS curve will shift *(leftwards / rightwards)*.
- In the long run, the price level will increase further and the output level will return to the full-employment output level.

©Aristo Educational Press Ltd.

18.3 Effects of Changes in Aggregate Supply on the Equilibrium Output and Price Levels

5. Suppose an economy is initially at the long run equilibrium. If the short run aggregate supply decreases, how would the price and output levels change in the short run and the long run? Explain your answer with the aid of the following diagram.

- When there is a decrease in short run aggregate supply, the SRAS curve shifts to the *(left / right)*.
- In the short run, the price level *(increases / decreases)* and the output level *(increases / decreases)*.
- There is *(an inflationary gap / a deflationary gap)*. There is an *(excess demand / excess supply)* in the factor market, resulting in *(an upward / a downward)* pressure on input prices. The cost of production will *(increase / decrease)*. Short run aggregate supply will *(increase / decrease)* and the SRAS curve will shift *(leftwards / rightwards)*.
- In the long run, the price level will return to the original level and the output level will return to the full-employment output level.

©Aristo Educational Press Ltd.

6. Suppose an economy is initially at the long run equilibrium. If the long run aggregate supply decreases, how would the price and output levels change? Explain your answer with the aid of the following diagram.

- When the long run aggregate supply decreases, the LRAS curve will shift to the *(left / right)*.
- The price level will *(increase / decrease)* and the output level will *(increase / decrease)*.

©Aristo Educational Press Ltd.