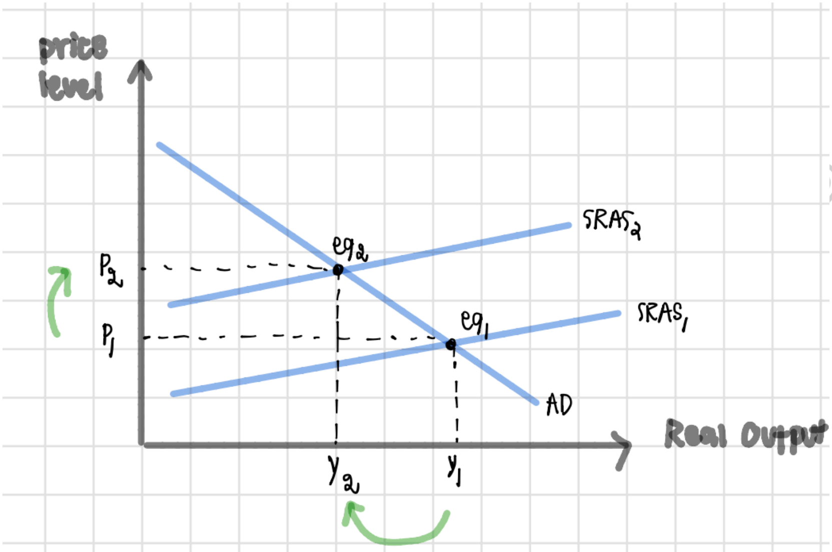
CHAPTER 33 : Equilibrium levels of real national output

Key terms

1. Classical economists : who hold the view that the long-run aggregate supply (LRAS) is vertical. So an increase in aggregate demand, in the long run, will be purely inflationary unless the LRAS curve shifts to the right
2. Equilibrium level of output : the level of real national output (real GDP) when aggregate demand equals aggregate supply
3. Full employment : the level of real national output where LRAS curve is vertical
4. Long-run disequilibrium : a term used by classical economists when the short run equilibrium level of real GDP is either below or above the level of real national output (real GDP) where the LRAS curve is vertical
5. Long-run equilibrium : when aggregate demand equals long-run aggregate supply

1. Equilibrium in short run

Eg. Wages increases/ raw material price increases



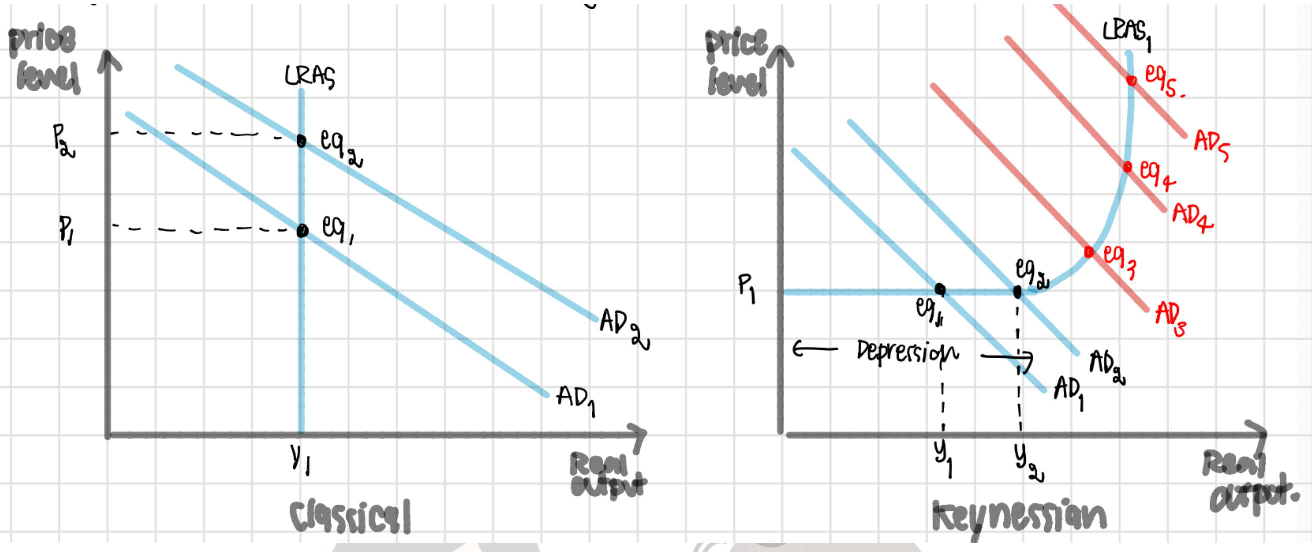
: Higher cost of production, a fall in SRAS from SRAS1 to SRAS2

: SRAS shifts left and achieve new EQ2

: Price increases from P1 to P2 and real output decreases from Y1 to Y2

2. Equilibrium in long run

Eg. Increase in government spending



: When government increases in spending.

AD = C+I+G+NX

: G increases, AD increases , New EQ2

: Price increases to P2, However, real output stays the same since economy achieves full Capacity.

: When government increases spending (AD = C+I+G+NX)

: New EQ2 will be from EQ1 to EQ2

: AD increases in spare capacity, real output can increase without inflation

: However, if government spending increases in the period of full capacity (AD4 to AD5)

: It can generate demand-pull inflation.