Exercise walk-through

Aggregate Demand and Aggregate Supply analysis ▪ 4.3

eXercise

You must be able to

- state the components of AD and explain its slope
- distinguish SRAS from LRAS
- draw AD–AS and analyse a shift in equilibrium

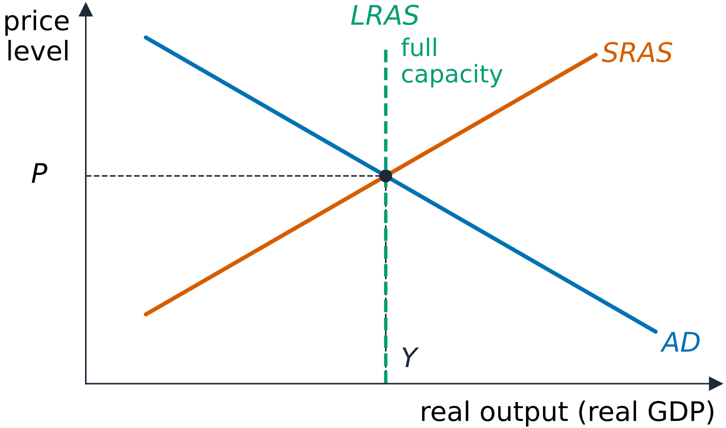
Method — AD–AS equilibrium

$$AD = C + I + G + (X - M)$$

- **C** consumption, **I** investment, **G** government spending, **(X − M)** net exports.
- **SRAS 短期总供给** slopes up (shifts when costs change); **LRAS 长期总供给** is vertical at full capacity.
- **Equilibrium** where AD meets AS → sets the **price level** and **real output**.

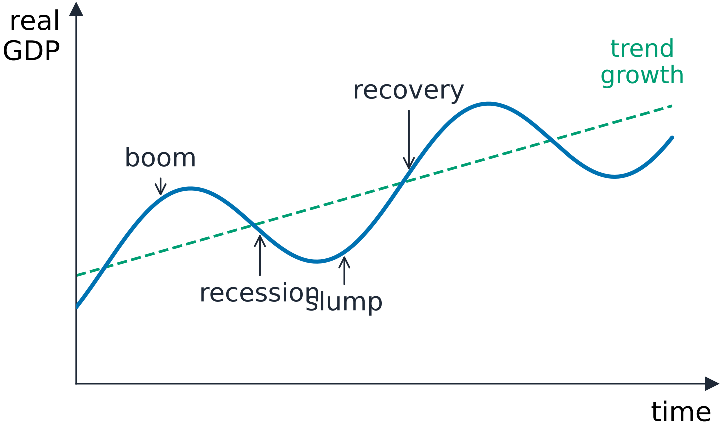
Answer shapes: an **Explain [up to 8]** answer should use a labelled AD–AS diagram (AO3); **Discuss [12]** adds a judgement (AO4).

Method — AD–AS equilibrium



Equilibrium sets the price level and real output where AD meets AS

Method — AD–AS equilibrium



Real GDP swings through boom, recession, slump and recovery around its rising trend

Practice 2.1 ▪ 2 marks

State the four components of aggregate demand.

Solution 2.1

Worked steps

consumption (C), investment (I), government spending (G), net exports $(X - M)$ (2 for all four; 1 for two or three).

Practice 2.2 ▪ 2 marks

State the difference between SRAS and LRAS.

Solution 2.2

Method: AD–AS equilibrium

Worked steps

SRAS slopes upward and shifts when production costs change; LRAS is vertical and shows full productive capacity, shifting only when factors change (2 for a clear difference; 1 for a partial idea).

Practice 2.3 ▪ 1 mark

State one cause of a rightward shift in AD.

Solution 2.3

Worked steps

any one of: a rise in C/I/G; a tax cut; a fall in interest rates; a rise in exports (1).

Exam-style 3.1 ▪ 1 mark

A cut in income tax is most likely to:

A shift AD left

B shift AD right

C shift SRAS left

D shift LRAS right

Solution 3.1

A shift AD left

B shift AD right ✓

C shift SRAS left

D shift LRAS right

Worked steps

B. A tax cut raises disposable income and consumption, shifting AD right.

Exam-style 3.2 ▪ 8 marks

Using an AD–AS diagram, explain how an increase in aggregate demand affects the price level and real output.

Solution 3.2

Method: AD–AS equilibrium

Worked steps

[8] AO1 1 + **AO3 diagram up to 4** (AD shifts right, SRAS upward-sloping, new equilibrium) + AO2/AO3 up to 3 — higher AD raises both the price level and real output along SRAS; near full capacity (steep AS) most of the rise is in prices, while with spare capacity (flat AS) most is in output.

Exam-style 3.3 ▪ 12 marks

Discuss whether a rise in aggregate demand always benefits an economy.

Solution 3.3

Method: AD–AS equilibrium

Worked steps

[12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **For:** higher AD raises output and employment when there is spare capacity. **Against:** near full capacity it mainly causes demand-pull inflation, may worsen the current account (more imports) and is unsustainable. Judgement: the effect depends on how close the economy is to full capacity — beneficial in a recession, inflationary in a boom.