Exercise walk-through

Changes in the AD–AS Model in the Short Run ▪ 3.6

eXercise

You must be able to

- analyse how a shift in **aggregate demand** changes the price level and output
- analyse how a **supply shock 供给冲击** changes the price level and output
- explain **stagflation 滞胀** as the result of an adverse supply shock

Method — An AD shift

- AD **right** $\rightarrow$ higher price level, higher output.
- AD **left** $\rightarrow$ lower price level, lower output.

Method — A supply shock

SRAS **left** (e.g. costlier oil) $\rightarrow$ higher price level **and** lower output — the combination called **stagflation**.

Method — Stagflation

Rising prices together with falling output (and rising unemployment), the tell-tale sign of an adverse supply shock.

Practice 2.1 ▪ 2 marks

State the effect of an increase in AD on the price level and output.

Solution 2.1

Worked steps

the price level rises and output rises **B1** **B1**.

Practice 2.2 ▪ 1 mark

Define stagflation.

Solution 2.2

Worked steps

rising prices together with falling output **B1**.

Practice 2.3 ▪ 1 mark

State what causes stagflation.

Solution 2.3

Worked steps

an adverse (negative) supply shock **B1**.

Exam-style 3.1 ▪ 1 mark

A fall in AD in the short run causes

A higher price level and output

B lower price level and output

C higher price level, lower output

D no change

Solution 3.1

A higher price level and output

B lower price level and output ✓

C higher price level, lower output

D no change

Worked steps

B.

Exam-style 3.2 ▪ 1 mark

Stagflation is

A high growth and low inflation

B high inflation with falling output

C deflation

D full employment

Solution 3.2

A high growth and low inflation

B high inflation with falling output ✓

C deflation

D full employment

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

A severe drought sharply raises food and input prices across the economy.
(a) State which curve shifts and in which direction.
(b) State the effect on the price level.
(c) Name the resulting condition.

Solution 3.3

Worked steps

(a) SRAS shifts to the left **B1**. (b) it rises **B1**. (c) stagflation **B1**.