CONCEPT: EQUILIBRIUM IN THE AD-AS MODEL – SHIFTS IN AGGREGATE DEMAND

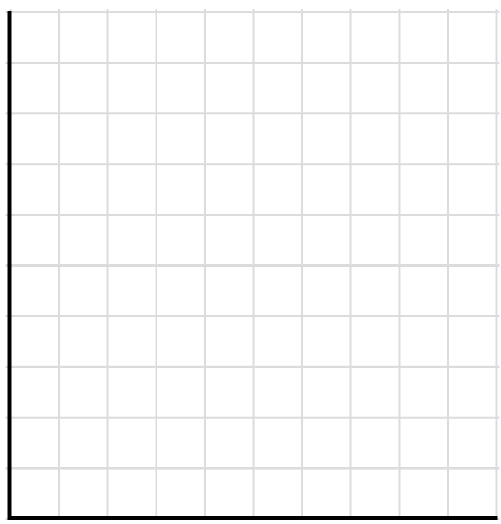
● A shift in AD will always follow a three step process:

- □ First, a shift occurs in AD ("Good" or "Bad"?)
- □ Second, a new short-run equilibrium is found (Intersection of AD_2 and $SRAS_1$)
- □ Third, an opposite shift occurs in SRAS leading to a new long-run equilibrium → *SRAS finds LR equilibrium*
    - > Note that this third step takes time; it does not immediately follow the first shift

● A ***decrease in AD*** leads to a ***recession and cyclical unemployment***

EXAMPLE: A decrease in expected future profit has led to decreased investment spending:

Decrease in Aggregate Demand



● An ***increase in AD*** is referred to as ***demand-pull inflation*** because the shift leads to a higher long-run equilibrium price

EXAMPLE: An increase in defense spending by the government:

Increase in Aggregate Demand