CONCEPT: SHORT RUN AGGREGATE SUPPLY

● The ***aggregate demand and aggregate supply model (AD-AS Model)*** explains short-run fluctuations in GDP and price

□ ***Aggregate Supply*** is different in the short-run and the long-run

> Short Run: The quantity of Real GDP is affected by current price levels

- Real GDP = goods and services produced

> In the short run, an increase in the price level will lead to ________ production of goods (and vice versa)

Short Run Aggregate Supply Curve

● There are three explanations why we can expect the SRAS to slope upwards:

□ ***Sticky Wage Theory*** says that wages (cost of labor) do not increase as quickly as the price level

> Profit = Selling Price – Cost

> Example: Union wages are set in contracts lasting several years; if economy booms, wages don't boom

□ ***Sticky Price Theory*** says that some prices do not increase in line with the price level because of ***menu costs***

> ***Menu Costs*** – the costs businesses face from changing prices

> Example: Price level increases but a restaurant does not want to take the cost of printing new menus

- This restaurant will have lower prices, increasing their sales quantity, leading to higher output

□ ***Misperceptions Theory*** says that increases in general price levels cause firms to respond with increased output