CONCEPT: DYNAMIC AD-AS MODEL – EXPANSIONARY AND CONTRACTIONARY MONETARY POLICY

● The ***dynamic AD-AS model*** fixes some of the issues with the AD-AS model by removing some key assumptions

□ The dynamic AD-AS model incorporates:

> Potential GDP increases over time → LRAS shifts ___________

> Aggregate supply tends to increase over time → SRAS shifts ___________

> Aggregate demand tends to increase over time → AD shifts ___________

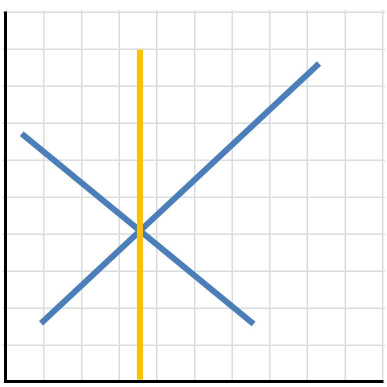
□ When the economy is ***in recession***, real GDP is below its potential output

> ***Expansionary monetary policy*** – Fed ______________ interest rates to stimulate economy

- Expansionary = more GDP

Expansionary Monetary Policy

Dynamic AD-AS Model



1. Equilibrium is initially at Point A on the graph
2. Dynamic model increases to AD, SRAS, and LRAS
3. AD did not grow enough to reach the new LR equilibrium
4. New SR equilibrium is at Point B
5. Expansionary Monetary Policy boosts AD
6. Economy is at potential GDP (LR equilibrium; Point C)

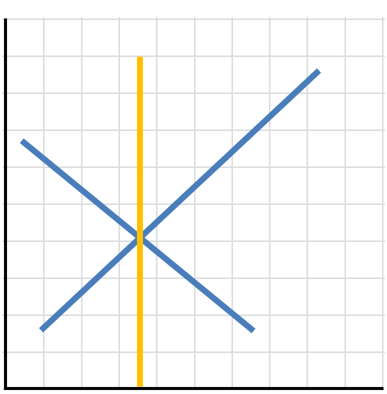
□ When the economy is experiencing ***rising inflation***, real GDP is above its potential output

> ***Contractionary monetary policy*** – Fed ______________ interest rates to reduce inflation

- Contractionary = less GDP

Contractionary Monetary Policy

Dynamic AD-AS Model



1. Equilibrium is initially at Point A on the graph
2. Dynamic model increases to AD, SRAS, and LRAS
3. AD grew too much and passed the new LR equilibrium
4. New SR equilibrium is at Point B
5. Contractionary Monetary Policy reduces AD
6. Economy is at potential GDP (LR equilibrium; Point C)