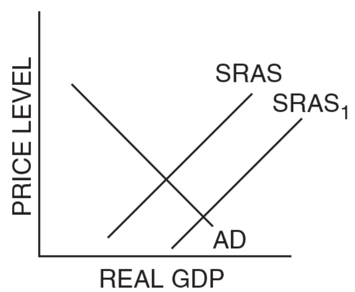
Changes in Short-Run Aggregate Supply and Aggregate Demand Answer Key

The equilibrium price and quantity in the economy will change when either the short-run aggregate supply (SRAS) or the aggregate demand (AD) curve shifts. The AD curve shifts when any of the components of AD change—consumption (C), investment (I), government spending (G), exports (X), or imports (M). The aggregate supply (AS) curve shifts when there are changes in the price of inputs (e.g., nominal wages, oil prices) or changes in productivity.

Changes in the Equilibrium Price Level and Output

For each situation described below, illustrate the change on the AD and AS graph and describe the effect on the equilibrium price level and real gross domestic product (GDP) by circling the correct symbol: ↑ for increase, ↓ for decrease, or — for unchanged

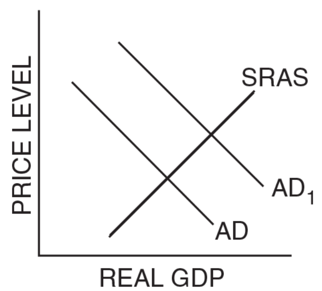
1. Business investment increases.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

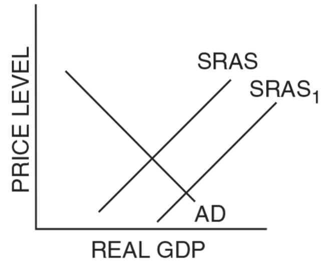
2. The government increases spending.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

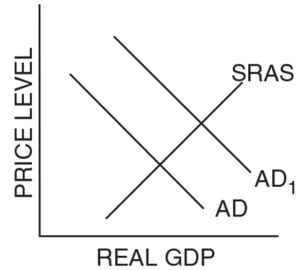
3. New oil discoveries cause large decreases in energy prices.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

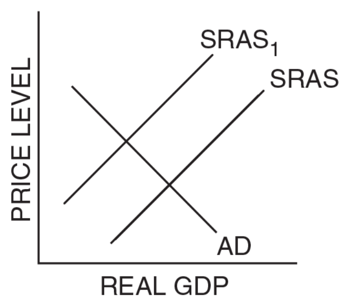
4. Consumer spending increases.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

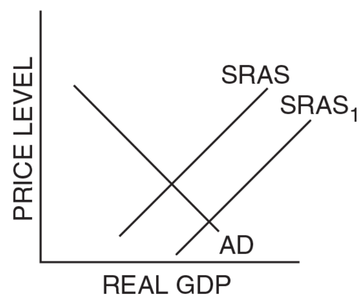
5. Production costs increase.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

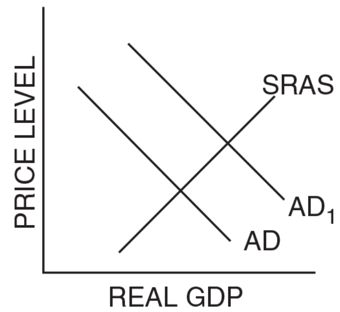
6. New technology and better education increase labor productivity.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

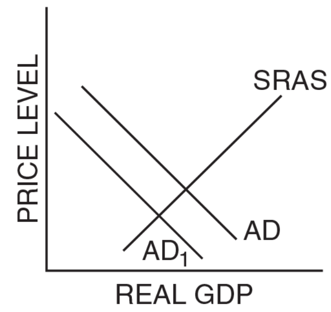
7. Consumers' confidence improves.



Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

8. Net exports decrease.



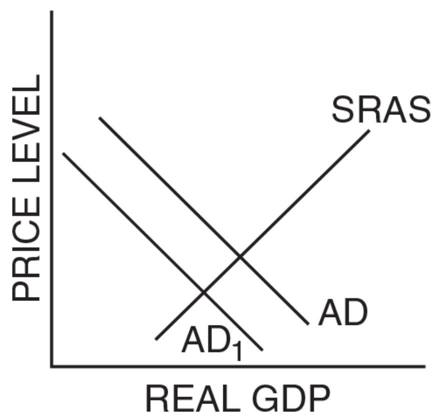
Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

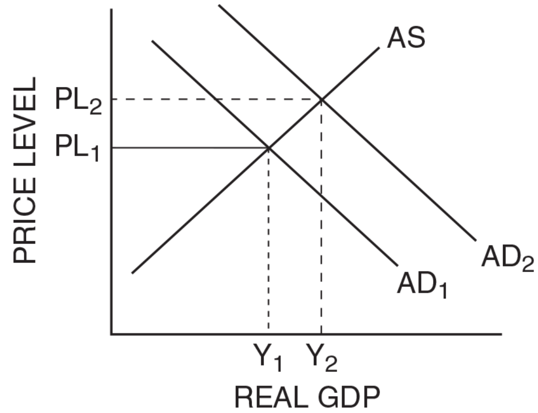
Graphing Demand and Supply Shocks

Draw an AS/AD graph to illustrate the change given in each of the questions below. On your graph be sure to label the axes (PL and Y), the AS and AD curves, and the starting and ending equilibrium PL and Y (these should be placed on the axes).

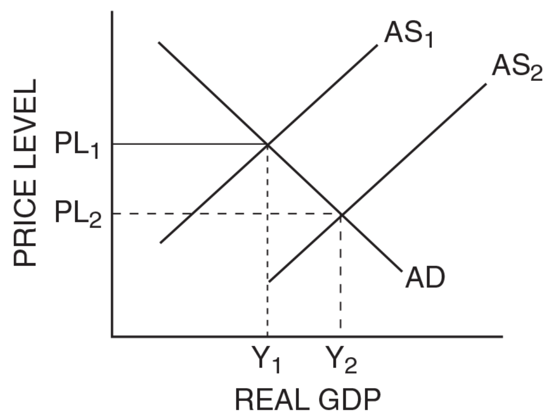
9. Economic booms in both Japan and Europe result in massive increases in orders for exported goods from the United States.



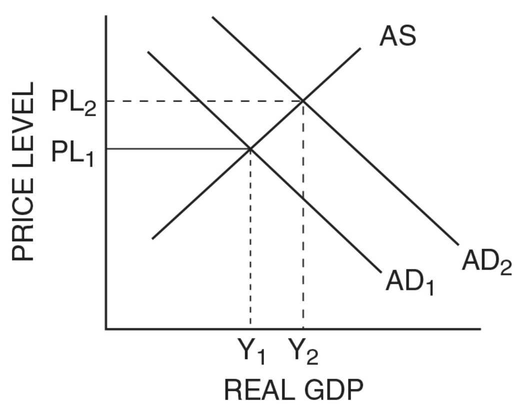
10. The government reduces taxes and increases transfer payments.



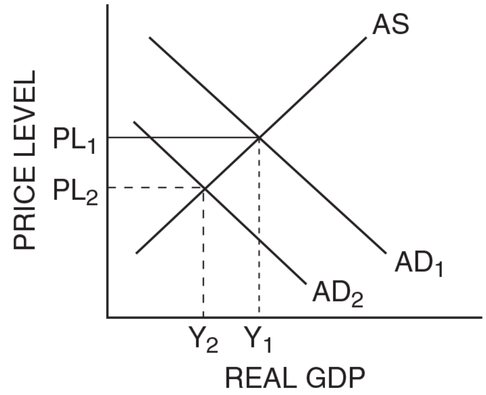
11. Fine weather results in the highest corn and wheat yields in 40 years.



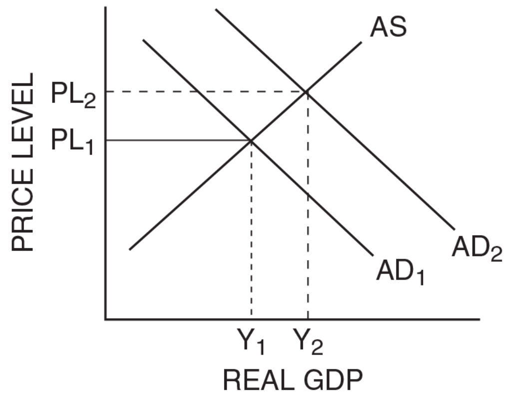
12. While the United States was in the midst of the Great Depression, a foreign power attacked, Congress declared war, and more than 1,000,000 soldiers were drafted in the first year while defense spending was increased several times over.



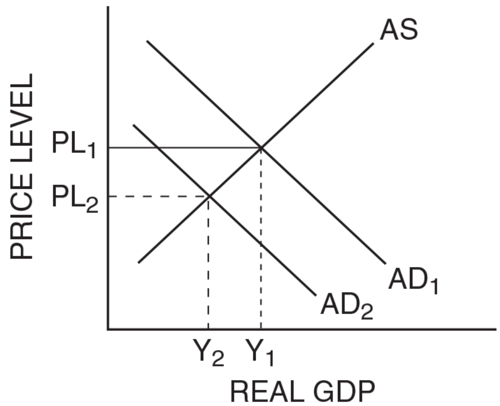
13. To balance the budget, the federal government cuts Social Security payments by 10 percent and federal aid to education by 20 percent.



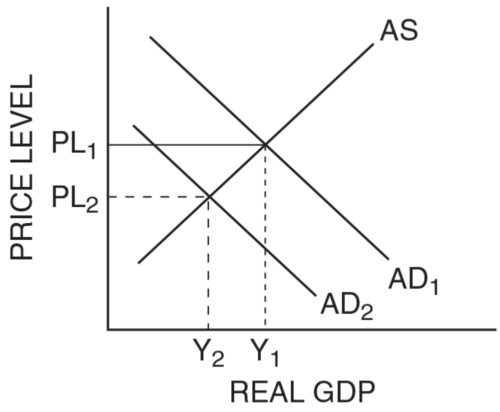
14. During a long, slow recovery from a recession, consumers postponed major purchases. Suddenly they begin to buy cars, refrigerators, televisions, and furnaces to replace their failing models.



15. In response to other dramatic changes, the government raises taxes and reduces transfer payments in the hope of balancing the federal budget.



16. News of possible future layoffs frightens the public into reducing spending and increasing saving for the feared "rainy day."



Excerpted from:

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