

AD-AS Model

1. Explain why AD is downward-sloping (that is, how AD is derived), using the money market diagram and the IS-LM.

2. What is Sticky Wage Theory? Explain why SRAS is upward-sloping (that is, how SRAS is derived), using the sticky wage theory, labor demand diagram, and production function.

3. Explain why LRAS is vertical.

4. **Ceteris Paribus** (other things equal), how will each variable/event affect each curve – shift (to which direction?) or movement?

Variable/Event	AD	SRAS	LRAS
P↑			
G↓			
T↓			
Autonomous C↑			
Autonomous I↓			
M↓			
i↑			
Temporary epidemic (assuming AD unchanged)	No effect		
Permanent increase in population growth rate (assuming AD unchanged)	No effect		
W↑			
Bad seasonal weather			

Permanent loss in agricultural land due to climate change			
Discovery of new technology			
Short-term worker training			
Permanent education reform			

5. Suppose the economy faces a negative AD shock (e.g. loss in consumers' confidence).
 - What output gap do we have? Draw the AD-AS diagram to show the output gap at the new short-run equilibrium.
 - If the government wants to correct such output gap, what policies can it implement? Give examples.
 - If there is no government intervention, explain with the AD-AS diagram how the economy will return to the long-run equilibrium.

6. Suppose the economy faces a temporary, positive AS shock.
 - Give one example of a temporary, positive AS shock.
 - If there is no government intervention, explain with the AD-AS diagram how the economy will return to the long-run equilibrium.

7. Suppose the economy faces a permanent, negative AS shock.
 - Give one example of a permanent, negative AS shock.
 - If there is no government intervention, explain with the AD-AS diagram how the economy will return to the long-run equilibrium.