2.4.3 Equilibrium levels of real national output

a) *The concept of equilibrium real national output*
b) *The use of AD/AS diagrams to show how shifts in AS cause changes in the equilibrium price level and real national output*

- When aggregate demand meets aggregate supply there is an equilibrium point, which tells us the price level and real GDP of a country. A shift of either curve will cause this shift to change.
- If prices were higher than the balancing point, PL_e, there would be a tendency for them to fall as supply would be greater than demand and there would be lots of unsold goods and services
- If prices were lower than the balancing point, there would be shortages and prices would start to rise in order to make sure that everyone could get what they were prepared to pay for
- If a world recession and fall in aggregate demand occurred, you would expect to see falls in price (or they wouldn't rise as quickly)
- When AD shifts to the right (expansionary) then we would expect there to be an increase in the equilibrium level, i.e. inflation, and an increase in growth.
- When AS is elastic there is a lot of spare capacity in the economy. An initial injection shifts the AD curve and the multiplier gives a large rise in output
- When AS is inelastic, there is much less spare capacity so an initial shift in AD cannot be multiplied- there's a smaller rise in output but a large rise in prices
- The results of shifts in the AD curve depend on the AS curve's slope. The more elastic the AS, the more the effect is seen on the growth axis rather than the price level axis.
- When AS is elastic there is a lot of spare capacity in the economy so after an injection the multiplier can take effect to give a large rise in output but when there isn't a lot of spare capacity this limits the effect of the multiplier
- If AS is perfectly inelastic (classical approach), there will be no effect on output at all from shifts in the AD curve just price rises because the economy is already running at full capacity
- If AS is perfectly elastic (Keynesian output gap approach), then there will be no effect on output or prices at all by a right shift in AD. The only affect would be an increase in output gap