

Chapter 6 – Real GDP and Price Level in the Long Run

1. The sum of all planned expenditures in an economy is called (aggregate demand, aggregate demand curve). The sum of planned production in the economy is called (aggregate supply, aggregate supply curve).

2. The long-run aggregate supply curve is (horizontal, vertical) because, in the long run, there is (full, incomplete) information, and full adjustment to changes in the price level can occur.

3. The aggregate demand curve relates planned expenditures of all goods and services to various _____. The aggregate supply curve relates planned rates of total production for the entire economy to various _____.

4. The aggregate demand curve is _____ sloped due to three effects: _____, _____, and _____.

5. When the price level rises (other things being constant), the real wealth of people who hold cash balances (falls, rises). Therefore, planned purchases of goods and services will (fall, rise).

6. When a nation's price level falls (other things being constant), its exports (rise, fall) and its imports (rise, fall). Therefore, total planned purchases will (rise, fall).

7. When the price level falls, people will want to hold (more, less) money in order to carry out the same transactions. This decrease in the demand for money causes interest rates to (rise, fall). Such a change in the interest rate causes households to plan to purchase (more, fewer) consumer durables, and businesses to plan to purchase (more, fewer) capital goods.

8. If government spending rises and taxes fall, the AD curve will shift to the (left, right). If the economic forecast is rosy, the AD curve will shift to the (left, right). If the money supply falls, the AD curve shifts to the _____.

9. If the position of the aggregate demand curve remains unchanged, then economic growth causes the long-run equilibrium price level to (decline, increase). This is called _____.

10. Which one of the following does not cause the AD curve to shift?

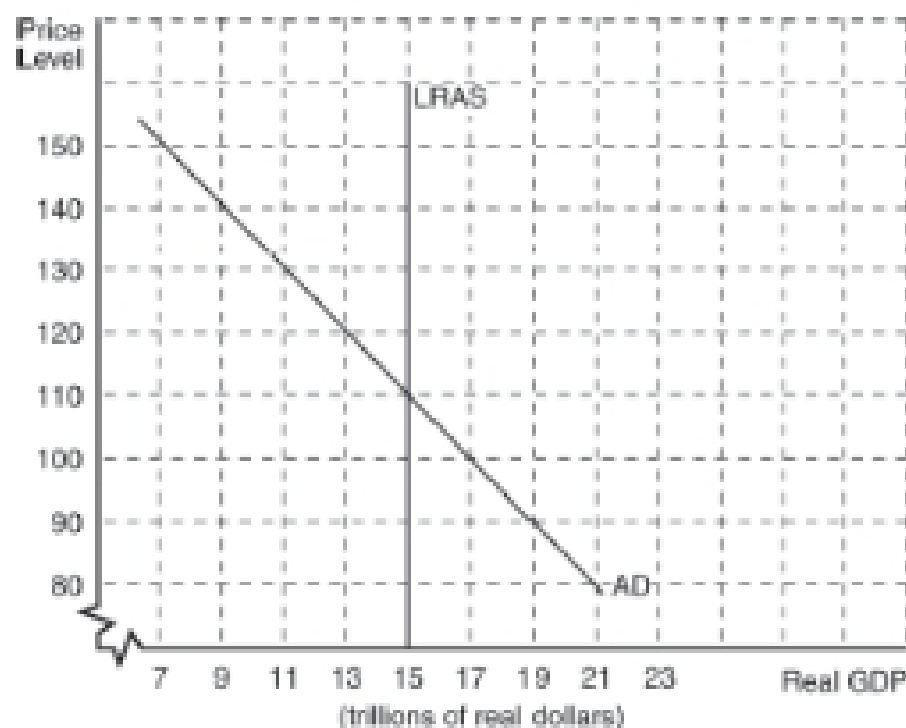
- a. an increase in taxes
- b. a decrease in the real interest rate
- c. a decrease in the price level
- d. a change in the money supply

11. Which of the following must be true of a long-run deflationary situation in which real GDP is increasing?

- I. The AD curve must be shifting rightward, ceteris paribus.
- II. The LRAS curve must be shifting leftward, ceteris paribus.
- III. The LRAS curve must be shifting rightward, ceteris paribus.

- a. I only
- b. III only
- c. both I and II only
- d. both II and III only

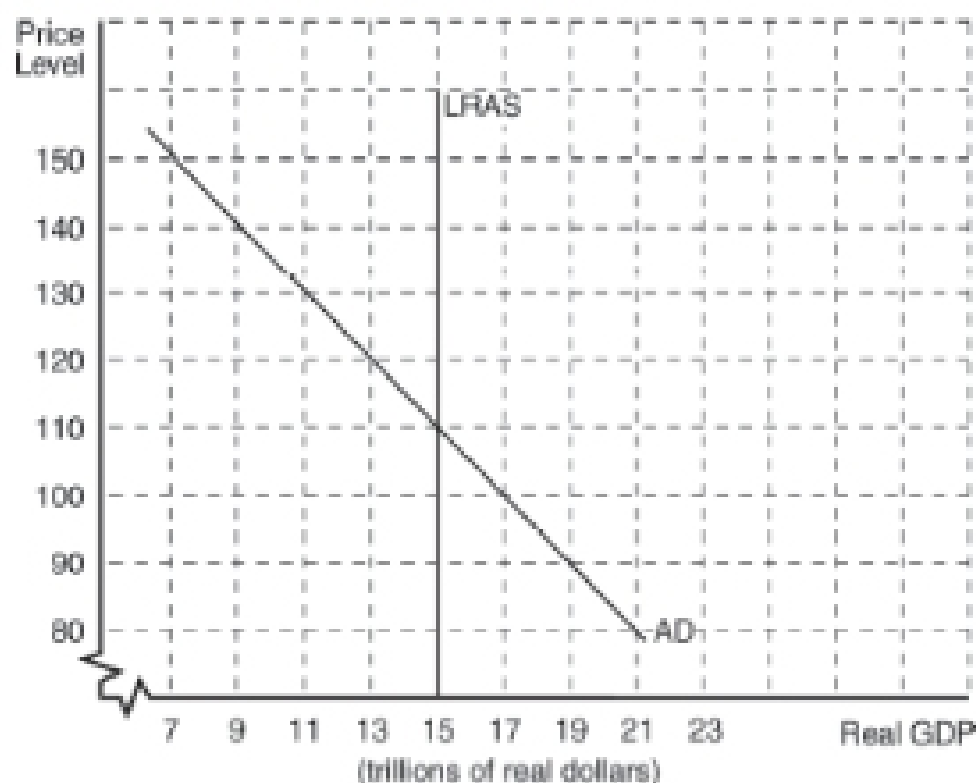
12. Consider the graph below, and then answer the following questions.



a. What is the current long-run equilibrium level of real GDP? What is the current long-run equilibrium price level? _____.

b. If the economy grows sufficiently that \$2 trillion in additional real GDP is forthcoming in the long run, and if aggregate demand remains unchanged, what will be the new long-run equilibrium price level? _____.

13. Consider the diagram below, and suppose that long-run equilibrium real GDP rises by \$2 trillion, but the equilibrium price level remains unchanged. Assuming parallel shift(s) of any schedule, draw new schedules showing how this could take place.



14. T F Demand-side inflation occurs when LRAS remains unchanged but aggregate demand increases.

15. T F If people's preferences, income and purchase habits remain unchanged but LRAS increases, this is an example of supply-side inflation.