

# Aggregate Supply

Elias Yannopoulos

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# Thinking About Supply

- Resources (workers, capital, materials)  $\Rightarrow$  Firms  $\Rightarrow$  Output (goods, services)
- The firm cares about two groups of prices resource prices (wages, interest rates, input prices) and output prices
- How do firms respond when the **price level** increases?
- There are two possible responses
  - Increase output
  - Do not change output
- If input and output prices increase together then there should be no change in output
- If only output prices rise then firms should increase output
- What happens to supply when the price level changes?

# Slope of Aggregate Supply

- Long Run: Enough time for all prices to adjust
- Short Run: A time where some prices have not yet adjusted
- **Sticky prices** - a concept that some prices cannot change quickly in response shocks
- In this model, **input** prices are assumed to be stickier than **output** prices
- This gives us two AS curves, one for the long run and one for the short run
- The Short Run Aggregate Supply (SRAS) curve - has a positive slope like other supply curves
  - This is the curve for when input prices are assumed fixed but output prices flexible
- The Long Run Aggregate Supply (LRAS) curve - is the output that the economy can produce when all prices are flexible