AD/AS Model — Worksheet

Part A — The curves, their shifts and the business cycle

This worksheet develops the most heavily examined skill in Unit 4: drawing and shifting the AD, SRAS and LRAS curves accurately, and reading off the effect on the price level and real output.

For every AD/AS answer: (1) draw and label the axes (price level vs real GDP), (2) shift the correct curve and label the shift, (3) mark the new equilibrium, (4) state the effect on **both** the price level and real output. Missing the "both" step is the most common lost mark.

Worked example. A cut in interest rates raises consumption and investment → **AD shifts right** → new equilibrium at a higher price level and higher real output (an expansion).

The curves

1. Explain why the aggregate demand curve slopes downward. Refer to at least two of the effects involved.

2. Distinguish between the short-run aggregate supply curve and the long-run aggregate supply curve, including the slope of each and what causes each to shift.

3. For each factor, state whether it shifts AD, SRAS or LRAS, and in which direction: (a) a rise in business confidence; (b) a fall in world oil prices; (c) major investment in education and training; (d) a cut in income tax.

Shifting the model

4. On a fully labelled AD/AS diagram, show the effect of a large fall in aggregate demand. Label the shift and the new equilibrium, and state the effect on the price level and real output.

5. On a second diagram, show a leftward shift of SRAS caused by a supply shock. Explain the effect on the price level and output, and name this outcome.

Application

6. Use the AD/AS model to explain how a sustained rise in aggregate demand drives an expansion, and why continuing to boost AD once the economy is at full capacity becomes purely inflationary. Refer to the LRAS curve.

7. Explain how the AD/AS model can be used to represent the four phases of the business cycle.