WJEC (Wales) Economics A-level

Macroeconomics

Topic 1: Macroeconomic Theory

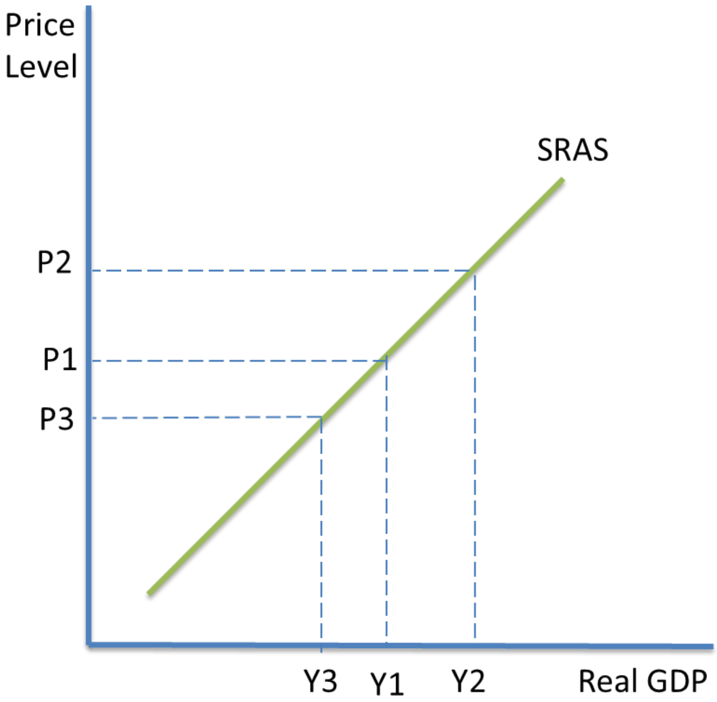
1.1 Short run aggregate supply (SRAS)

Notes

The AS curve:

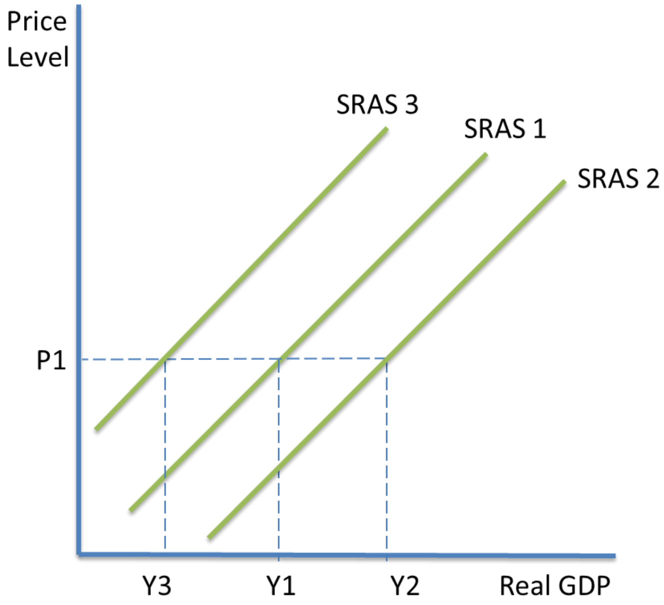
- Aggregate supply shows the quantity of real GDP which is supplied at difference price levels in the economy.
- The AS curve is upward sloping because at a higher price level, producers are willing to supply more because they can earn more profits.

Moving along the AS curve:



- Only changes in the price level, which occur due to changes in AD, lead to movements along the AS curve.
- If AD increases, there is an **expansion** in the SRAS, from Y1 to Y2. If AD falls, there is a **contraction** in SRAS, from Y1 to Y3.

Factors influencing short-run AS:



- The SRAS curve shifts when there are changes in the conditions of supply. The price level and production costs are the main determinants of SRAS.
  - The cost of employment might change, e.g. wages, taxes, and labour productivity. If costs increase, supply will shift inwards from SRAS1 to SRAS3.
  - The cost of other inputs e.g. raw materials, commodity prices, and the exchange rate if products are imported. A stronger currency reduces the price of imports, so imported products will be cheaper. This would shift the AS curve outwards, from SRAS1 to SRAS2.
  - Government regulation or intervention, such as environmental laws or green taxes and business regulation. Business regulation is sometimes called 'red tape'.
  - There could be a net outward migration of workers, which causes a 'brain drain' on the domestic economy, as skilled workers move elsewhere.
  - If there is a fall in business capital spending, supply will fall.

SRAS in this form is associated with Monetarist and Neo-Classical economists.

Monetarism emphasises government control over the money supply. This view believes that changes in the money supply influences national output in the short run, and influences the price level in the long run.

Rather than how confident firms feel, monetarists believe that interest rates have a greater influence over investment decisions.

Monetarists believe that inflation is caused by excessive quantities of money flowing in the system. If production increases at a slower rate to the money supply, monetarists argue that there will be inflation. The money supply increases when more money is printed or there are several loans and credit.