AD-AS Analysis

Step 1: Initial LR Equilibrium
Step 2: Shock
  - AD-shock (change in aut exp: consumer conf, wealth, mil spend, bus spend, technology, taxes, foreign demand)
  - LRAS-shock (potential output, productivity, war)
  - SRAS-shock (inflation shock, gas price change)
Step 3: Find SR Equil with shock
  - Check if gap rec or exp
Step 4: assess how economy self-corrects to shock
  - Step 4’: assess how shift of AD (mon/fiscal stabilization) can close gap immediately.

AD-AS: adverse inflation-shock
self-correction

1. Initial LR at A
2. Shock=SRAS1= π1
3. SR Equil (with shock) at B
4. Gap = Y*-Y1, rec gap
5. Self-corr, π falls back to π0

AD-AS: adverse potential output-shock
self-correction

1. Initial LR at A
2. Shock=LRAS1= Y1*
3. SR Equil (with shock) at A
4. Gap = Y1*-Y0, exp gap
5. Self-corr, π rises up to π1
New LR equil at B

AD-AS: adverse potential output-shock
stabilization (FED tightening or G dec/Tinc)

1. Initial LR at A
2. Shock=LRAS1= Y1*
(Mentally take Y0* out of pic)
3. SR Equil (with shock) at A
4. Gap = Y1*-Y0, exp gap
5. Quickly change SR equil to close gap. New LR equil at C