Chapter 13- Aggregate Demand, Aggregate Supply, and Business Cycles

* **Long run equilibrium-** a situation in which the AD and AS curves intersect at potential output Y\*
* **Short run equilibrium-** a situation where the AD and AS curves intersect at a level of real GDP that is above or below potential
* **Aggregate demand (AD) curve-** a curve that shows the amount of output consumers, firms, government, and customers abroad want to purchase at each inflation rate, holding all other factors constant
* **Monetary policy rule-** a rule that describes how a central bank, like the Fed, takes action in response to changes in the state of the economy
* **Change in aggregate demand-** a shift of the AD curve
* **Demand shocks-** changes in planned spending that are not caused by changes in output (GDP) or the inflation rate; for example, changes in consumer confidence and consumers’ real wealth can affect consumption even if there has been little change in output or inflation
* **Increase aggregate demand-** increase government spending, cut taxes, and decrease the real interest rate
* **Decrease aggregate demand-** decrease government spending, raise taxes, and increase the real interest rate
* **Aggregate supply (AS) curve-** a curve that shows the relationship between the amount of output firms want to produce and the inflation rate, holding all other factors constant
* **Change in aggregate supply-** a shift of the AS curve
* **Inflation shock-** a sudden change in the normal behavior of inflation, unrelated to the nation’s output gap; adverse inflation shock increases inflation while a favorable inflation shock decreases inflation
* **Self-correcting property-** the fact that output gaps will not last indefinitely, but will be closed by rising or falling inflation