Write in the box the number of the question you are answering on this page as it is designated in the examination.

1.

**Price**

Short run aggregate supply

i) Price increase from \( p \) to \( p' \)

ii) Output decrease from \( Y \) to \( Y' \)

**Inflation**

Short run curve shifts to the right as price level increases

increases and unemployment

Natural level of unemployment

C) By increasing money supply, the central bank lowers interest rates. A lower interest rate means higher level of investment. As investment is a part of aggregate demand, when investment increases, aggregate demand increases (\( AD = C + I + G \)) (shifts to the right)

Real output increase from \( Y \) to \( Y' \)

Price level increase from \( p \) to \( p' \)
Write in the box the number of the question you are answering on this page as it is designated in the examination.

`d) Lower production costs means increase in supply (shift to the right)`

```
<table>
<thead>
<tr>
<th>Price Level</th>
<th>Long run Aggregate Supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y</td>
<td>SRAS</td>
</tr>
<tr>
<td>Y'</td>
<td>SRAS'</td>
</tr>
</tbody>
</table>
```

```
<table>
<thead>
<tr>
<th>Aggregate Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y - Y'</td>
</tr>
<tr>
<td>Real GDP</td>
</tr>
</tbody>
</table>

i) Real output increase from Y to Y'

ii) Price level decrease from p to p'

Copyright © 2004 by College Entrance Examination Board. All rights reserved.
Visit apcentral.collegeboard.com (for AP professionals) and www.collegeboard.com/apstudents (for AP students and parents).```
As the price for oil, an important natural resource, which is used for further production, increases, the short-run aggregate supply (SRAS) shifts from SRAS to SRASE, or in other words, decreases. As a result of this shift, real output (Y) decreases from initial equilibrium level of Y₁ to new equilibrium level Y₂.
As shown on the graph on the previous page with the decrease of aggregate supply in the short-run, the price level will increase from the initial equilibrium level \( P_1 \) to the new equilibrium level \( P_2 \).
As the government decides to increase the money supply ($M^s$), the interest rate will fall from $R_1$ to $R_2$. As the result of decrease in interest rate, the investment level will increase from $I_1$ to $I_2$. This increase will lead to the increase in the aggregate demand in the short run from SRAD$_1$ to SRAD$_2$. On the level of the increased investment ($\Delta I$),
As the increase in investment shifts the AD curve, the real output increases from $y_1$ to $y_2$ and price level also increases from $P_1$ to $P_2$. 

Write in the box the number of the question you are answering on this page as it is designated in the examination.
The reduction in business taxes leads to an increase in consumption, which is one of the components of aggregate demand, so the AD curve will shift up from AD₁ to AD₂.

As it can be seen from the graph, the output level will increase from Y₁ to Y₂.
Write in the box the number of the question you are answering on this page as it is designated in the examination.

With the increase of AD, the price level also increase from P₁ to P₂.

But as long as taxes affect aggregate demand.
Write in the box the number of the question you are answering on this page as it is designated in the examination.

(a) Since the country's economy is in equilibrium,
increase in the price of oil makes production cost more, reducing the AS, so the AS graph shifts to the left.
(i) Shift of AS curve moved real GDP from Qe to Q0. Since Q0 < Qe, real output decreased.
(ii) Shift of AS curve moved price level from Pe to P0. Since P0 > Q0, price level increased.

(b) Since the aggregate supply decreases, both inflation rate and unemployment rate increases.
Write in the box the number of the question you are answering on this page as it is designated in the examination.

(i) Increase in the money supply will cause increase in purchasing power, shifting the AD curve to the right.

(ii) Q_m > Q_s, therefore, real output increases. P_m > P_s, therefore, price level increases.
Write in the box the number of the question you are answering on this page as it is designated in the examination.

1.

Reduced business tax decreases cost of production, moving the AS curve to the right.

(i) $Q_t > Q_0$, therefore, real output increases.

(ii) $P_t < P_0$, therefore, price level decreases.