inputs will rise
    - Firms raise prices to cover costs
    - High rate of expected inflation tends to lead to high rate of actual inflation
- Shifts result due to available resources, technology, expected inflation rates, and inflation shocks)
- If inflation expectations increase, aggregate supply will decrease
- Long-term contracts serve to build in wage and price increases that depend on inflation expectations at the time the contracts were signed
    - Reinforce inflation inertia
- If output gap is zero, the rate of inflation will remain the same
- When there is an expansionary gap, the rate of inflation will rise
- When there is a recessionary gap, the rate of inflation will fall
- Current inflation = expected inflation + change in inflation caused by an output gap
- Resources and technology shift the aggregate supply curve outward
- Inflation Shock: a sudden change in the normal behavior of inflation, unrelated to the nation's output gap
    - Negative: causes an increase in inflation
    - Positive: causes a decrease in inflation
- An economy with an expansionary gap sees the bidding up of wages and production costs
    - Causes a leftward shift in AS which results in higher inflation and decreased output

Self-Correcting Economy and Stabilization Policy

- Self-Correcting Property: the fact that output gaps will not last indefinitely, but will be closed by rising or falling inflation
    - Keynesian thinks it can only be done through fiscal/monetary policy
    - Keynesian focuses on the short run period where prices and inflation do not adjust
- Stabilization policies are most useful when the size of the output gap is large and the self-correction process is slow
- When firms face menu costs, they face a burden of altering prices
    - Will increase output to take advantage of higher demand and raise prices later
- When inflation rate increases, household wealth falls, which reduces PAE
    - National income falls --> output decreases
- If the Fed expects second-round effects, it will counteract the inflation (i.e.