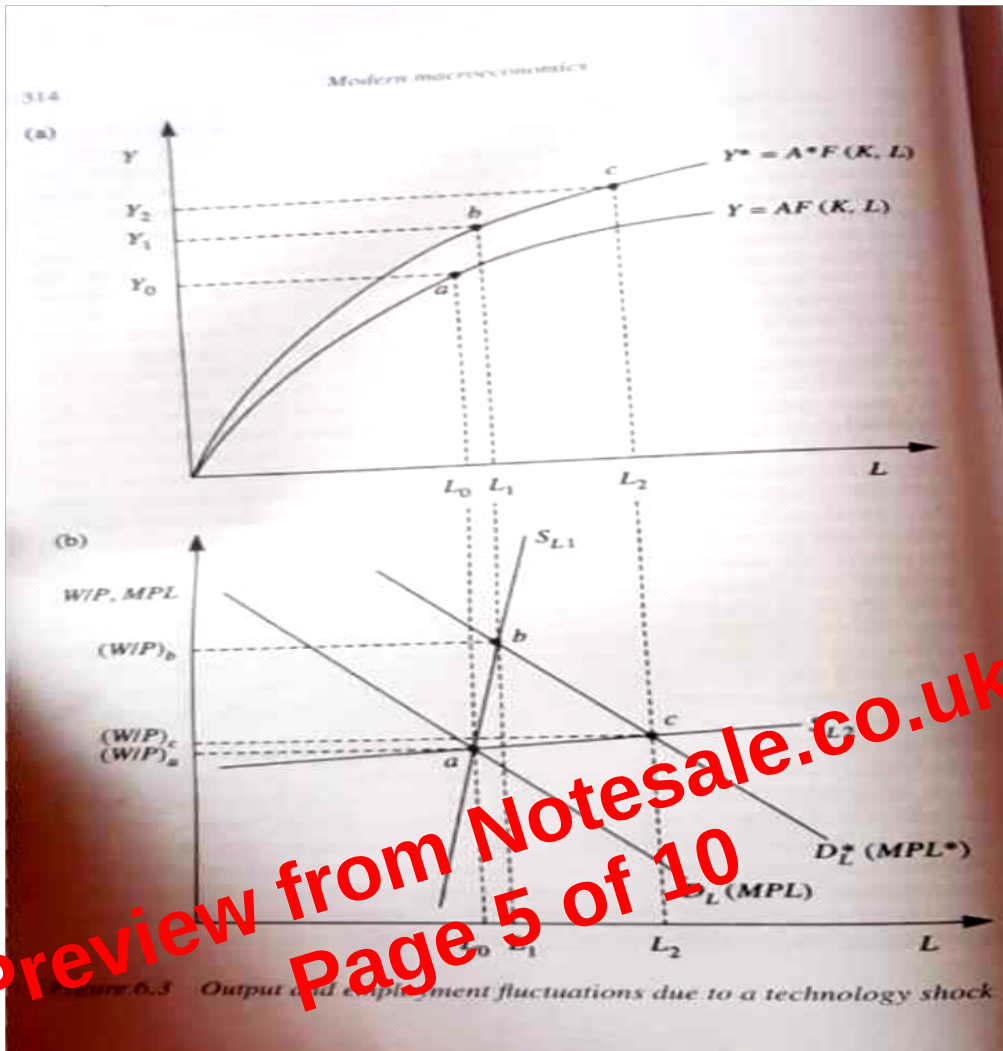




The above figure illustrate how aggregate output and employment vary in a real business cycle model. In the Figure Panel (a) illustrates the impact of a beneficial technology shock, which shifts the production function from  $Y$  to  $y^*$ . The impact of this shift on the marginal product of labour and hence the demand for labour is shown in panel (b). By increasing the demand for labour a productivity shock raises employment as well as output. How much employment expands will depend on the elasticity of labour supply with respect to the current real wage. For the labour supply- schedule to be highly elastic with respect to the