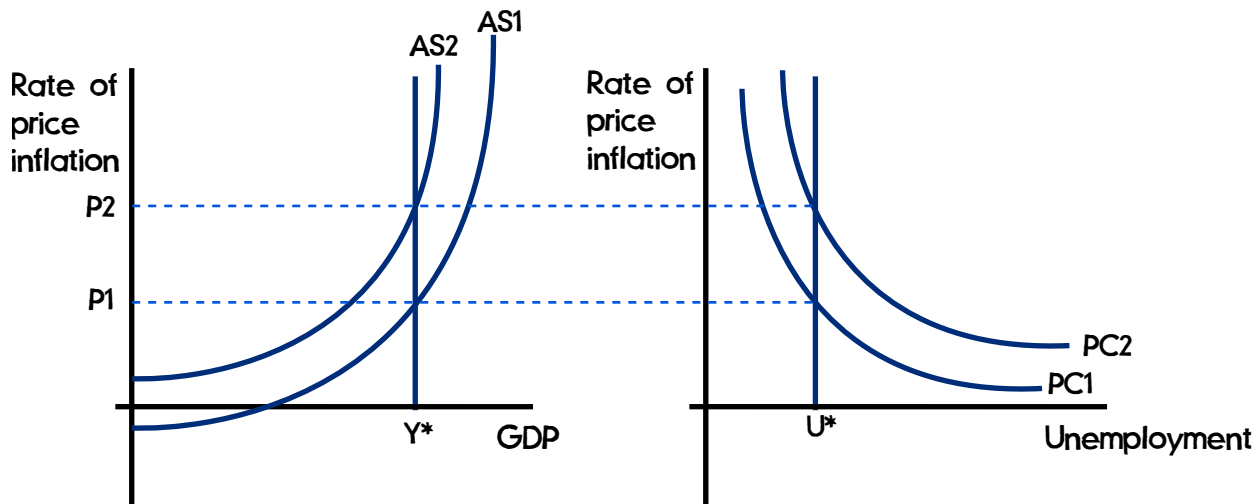


Low unemployment -> higher nominal wage -> rise in prices & price level -> workers ask for higher nominal wage -> further increases in price & price levels -> works ask for more
=> race between prices and wages leads to steady wage and price inflation
ACCELERATIONIST PHILLIPS CURVE - low unemployment leads to rise in inflation and acceleration of price levels
If expectations of future inflation rise -> AS and PC shift up



If firms expect higher market price inflation of both output and inputs
-> to maintain profits, increase rate at which actual prices rise

If employees expect higher price inflation

-> Will seek higher pay

-> If employer also expects higher inflation will agree (as can pass on costs)

=> Higher actual inflation

Inflation depends on output gap plus (business and household) expectations about future (of economy and inflation)

OUTPUT GAP - difference between current capacity and full capacity

$$\text{OUTPUT GAP} = Y - Y^*$$

$$P(\text{rate of } \Delta \text{inflation}) = \alpha P_e(\text{rate of } \Delta \text{expected inflation}) + 1\beta (Y - Y^*)$$

$$\alpha, \beta > 0$$

$$P(\text{rate of } \Delta \text{inflation}) = \alpha P_e(\text{rate of } \Delta \text{expected inflation}) + 1\beta (Y - Y^*)$$

$$\alpha > 0 \quad \beta < 0$$

If inflation is correctly forecast/anticipated

-> $\alpha = 1$ and $P = P_e$

-> $P - P_e = 0$

-> $Y = Y^*$ and $U = U^*$

Preview from Notesale.co.uk
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