Lecture 18: Inflation and Unemployment

- Current Events

- The Phillips Curve

- Nominal and real interest rates

The Phillips Curve

* The price level   vs   The inflation rate

$$P(t) = P^e(t) \, (1+\mu) \, F(u(t), z)$$

$\approx>$

$$\pi(t) = \pi^e(t) + (\mu+z) - \alpha \, u(t)$$

* original Phillips curve; Figures: 8-1/8-2/8-3/8-4/8-5

The Phillips Curve and The Natural Rate of Unemployment

$$\pi^e(t) = \pi(t)$$

$$=>$$

$$u_n = \frac{(\mu+z)}{\alpha}$$

$$\pi(t) = \pi^e(t) - \alpha(u(t) - u_n)$$

Inflation and Disinflation

* In the long run $\pi = g_m - g_y$

* Disinflation and credibility

$$\pi(t) = \pi^e(t) - \alpha(u(t) - u_n)$$

Real and Nominal Interest Rates

IS: $Y = C(Y-T) + I(Y,r) + G$

LM: $\dfrac{M}{P} = YL(i)$

$$\mathbf{r = i - \pi^e}$$

The Long Run: $\pi^e = \pi = g_m - g_y$ Changes are relatively small; a "constant."

Dynamics: Figure 14-6 / Evidence: Figure 14-7