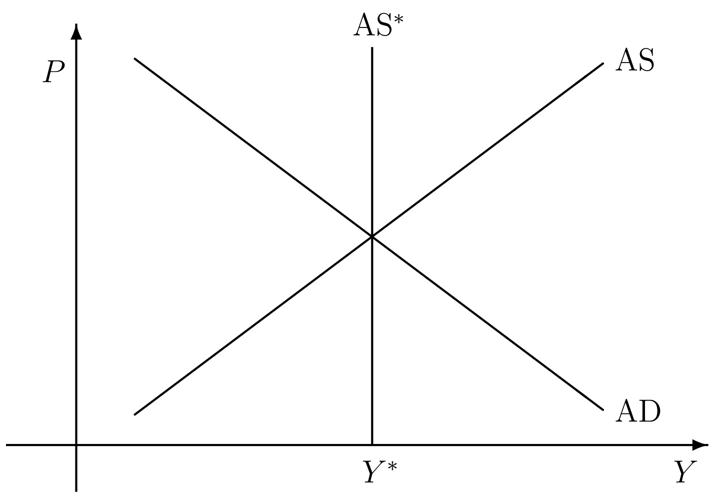
# A Crisis of Confidence?

Revised: November 9, 2013

You have rotated into the economic analysis group at JP Morgan Chase, reporting to US Chief Economist Michael Feroli. As your first assignment, he asks you to work through the possible impact on the US economy of further deterioration in Europe. He suggests that this might affect the US economy through three channels. First, Europeans may buy fewer US products. Second, financial conditions in Europe might spill over to the US, making it more difficult, for example, for US firms to finance expansion. And third, the loss of confidence there might lead to a fall in confidence of US business leaders.

You go back to your Global Economy notes, in particular the chapters on the aggregate supply and demand model, where you find this figure:




You remind yourself what it means and write down some questions:

- Where is the current short-run equilibrium in this diagram? Does that seem right to you?
- Do Feroli's channels correspond to changes in supply or demand?
- If you decide the primary effect is on demand, how would you expect GDP growth and inflation to respond in the short run? In the long run?
- What, if anything, do you think is missing from this analysis?