Graphical Representation of the Two-Market Model Solution

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Move from behavioral AD curve to pure AD curve.

$$\begin{cases} y = y^d = \sigma(x)\left[y^s + M/p \right] \\ y = y^s \end{cases}$$

$$\hookrightarrow \quad y = \sigma(x)\left[y + M/p \right]$$

$$[1-\sigma(x)]\, y = \sigma(x)\, \frac{M}{p}$$

$$y = \frac{\sigma(x)}{1-\sigma(x)} \cdot \frac{M}{p} \qquad \text{where } \sigma(x) = \frac{(\gamma_2+1)\gamma_3 X^{\gamma_3}}{(\gamma_2+1)\gamma_3 X^{\gamma_3} + 1}$$

MPS

$$y = \frac{X^{\gamma_3}}{\left[1 + \gamma_2\right] - \gamma_3} \cdot \frac{M}{p}$$

Pure AD

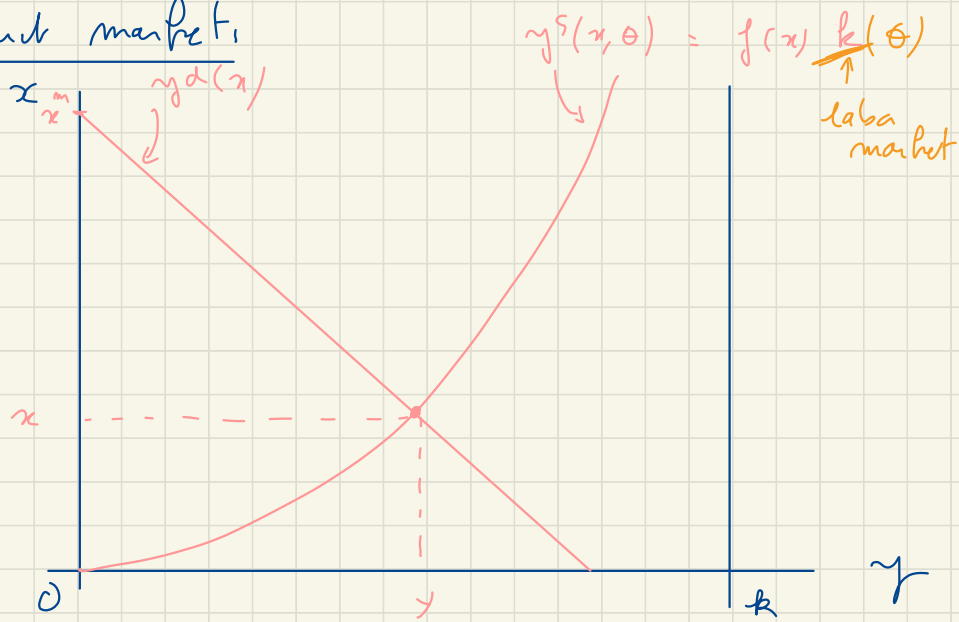
$$\boxed{y^d(x) = \frac{X^{\gamma_3}}{\left[1+\gamma_2\right]^{1-\gamma_3}} \cdot \frac{M}{p}}$$

Model solution:

$$\begin{cases} y^d(x) = y^s(x, \theta) \\ y = y^d(x) \\ \ell^d(x, \theta) = \ell^s(\theta) \\ \ell = \ell^s(\theta) \end{cases}$$

Graphical representation of solution w/ 2 diagrams

Product market:



Labor market: