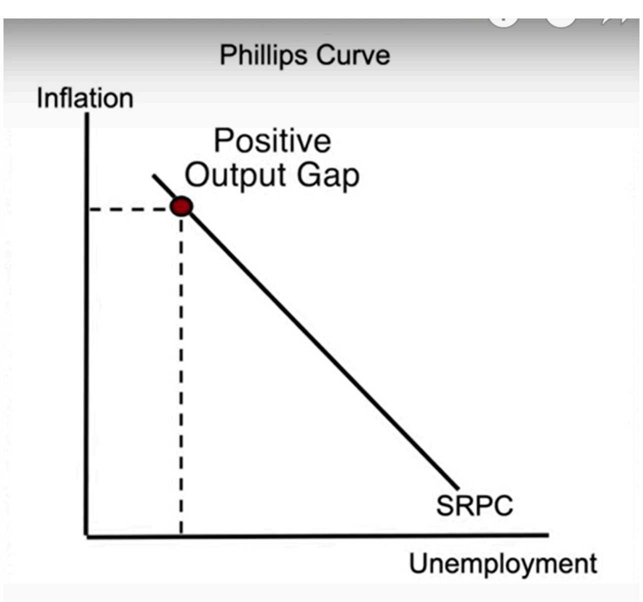
AP Dojo

AP Macroeconomics
Unit 5 - Cheat Sheet

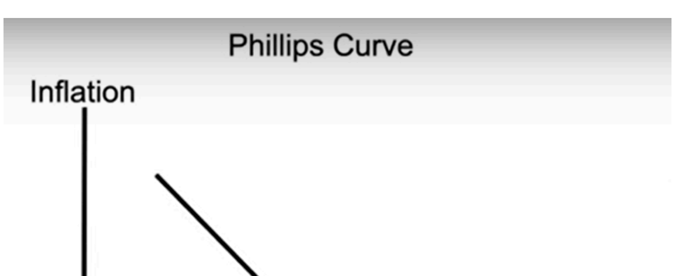
Phillips Curve - graphical model showing the inverse relationship between inflation and unemployment

- There is a short-run tradeoff between unemployment and inflation
- As labor becomes more scarce, companies must pay more and more to get the remaining labor
- Increased labor prices mean higher production costs, and therefore firms must increase the price of their goods and services (inflation)
- When unemployment is high, workers are willing to accept lower wages



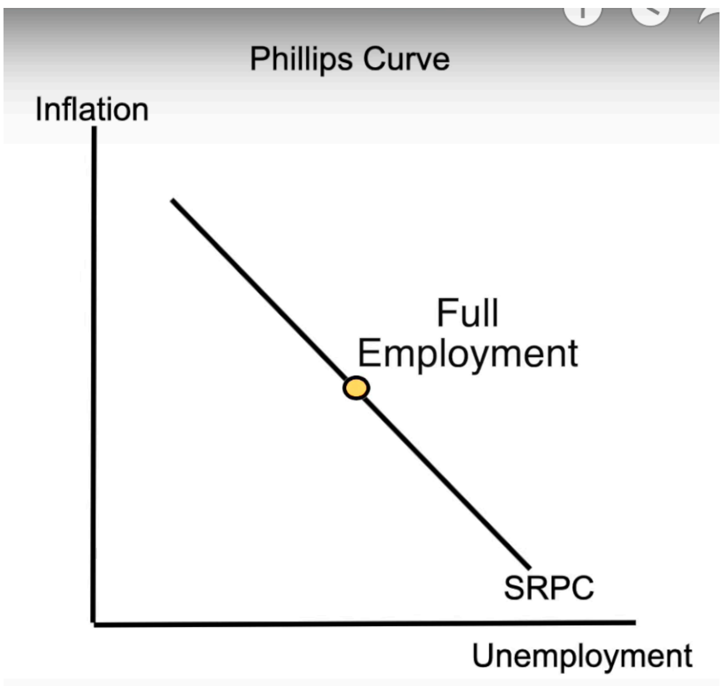
Positive Output Gap:

This point represents an inflationary gap, where production is high, unemployment is low, and prices rise



<u>Negative Output Gap:</u>

This point represents a recessionary gap, where production is low, unemployment is high, and there is little inflation

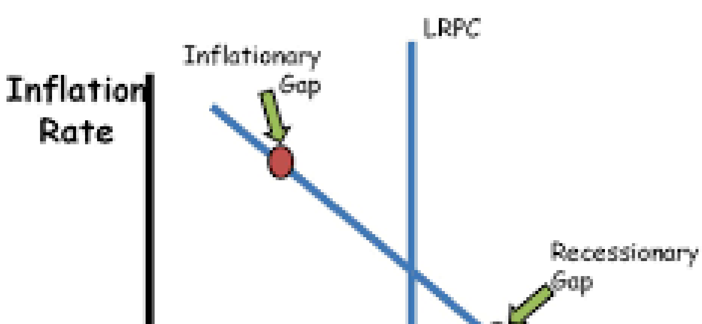


<u>Full Employment:</u>

Shows a situation where the economy is using its labor resources efficiently and producing at its point of potential output

<u>Long Run Phillips Curve:</u> represents the long-run relationship between the price level and unemployment.

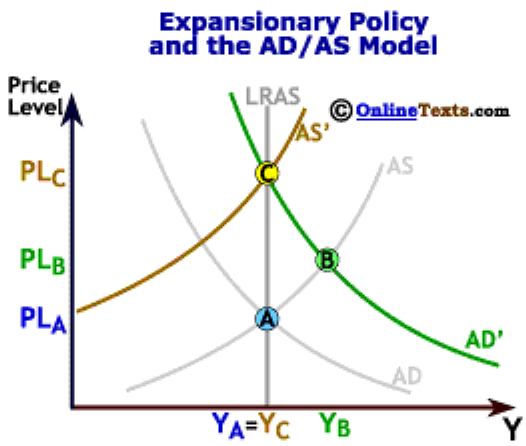
- In the long-run the Phillips curve is vertical, because the tradeoff that exists between unemployment and inflation in the short run doesn't exist in the long run.



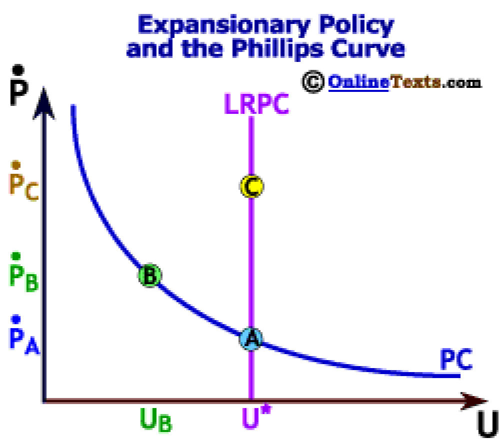
- Any shift of the aggregate demand curve will translate into a movement ALONG the Phillips curve
    - Decrease in aggregate demand --> downward movement along Phillips curve
    - Increase in aggregate demand --> upward movement along Phillips curve
- Any shift of the aggregate supply curve will translate into a SHIFT of the Phillips curve
    - Decrease in aggregate supply --> upward shift of Phillips curve
    - Increase in aggregate supply --> downward shift of Phillips curve

<u>Expansionary Policy and the Phillips Curve</u>

<u>Step 1:</u> The government implements expansionary fiscal policy that shifts aggregate demand to the right. Notice what happens to the price level.



Step 2: This increase in the price level can be shown by an upward movement along the Phillips curve

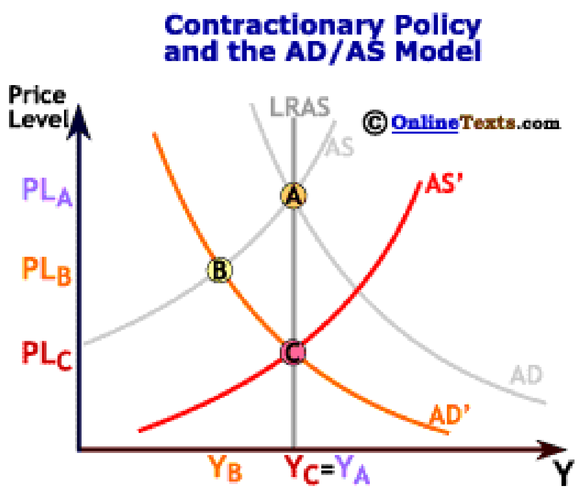


Step 3: Eventually aggregate supply will shift leftwards, as higher wages lead to less production by firms. This returns us to the long-run equilibrium (Point B to Point C)

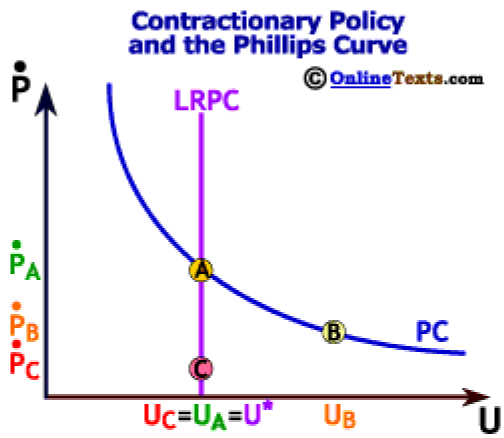
Step 4: This return to long-run equilibrium can be shown by a rightward shift in the Phillips curve

Contractionary Policy and the Phillips Curve

Step 1: A leftward shift of the aggregate demand curve leads to a decrease in the price level



Step 2: This decrease in the price level can be shown by a downward movement along the Phillips curve



Step 3: Eventually, due to lower price, aggregate supply will increase. This returns us to the long-run equilibrium (at a lower price)

Step 4: This return to long-run equilibrium can be shown by a leftward shift in the Phillips curve

ADDITIONAL HELP:
http://www.econweb.com/macro/phillips/notes.html

QUIZIZZ REVIEW ACTIVITY:
https://quizizz.com/admin/quiz/653e4e194b65e77bf695f9b8?fromSearch=true