

March 24:

## The Phillips Curve

$$\pi_t = \pi_t^e + \bar{v} \tilde{y} + \bar{o}$$

Inflation rate      expectations      location in Business Cycle      price shocks (increase in input costs for firms)

Adaptive expectations:  $\pi_t^e = \pi_{t-1}$

Inflation next year is equal to inflation at the previous year

$$\pi_t = \pi_{t-1} + \bar{v} \tilde{y}$$

$$\Delta \pi = \bar{v} \tilde{y}$$

$\bar{v}$  is the slope of the Phillips Curve

Volcker Disinflation:

- inflation rate falls

Increase interest rates  $\rightarrow$  recession  $\rightarrow$  stable inflation  $\rightarrow$  stable interest rates

# Modeling the Volcker Disinflation

