

An economy begins where actual output equals potential output. Illustrate and explain the impact of a fall in energy prices in the ISLMPC model with endogenous money and anchored inflation expectations. Discuss the distributional impact of the fall in energy prices depending on whether the central bank, firms, or workers have the power to adjust the economy to keep inflation at its target rate after the fall in energy prices. With reference to readings and content in the module, discuss whether it is important to consider income distribution in macroeconomic analysis.

Plan:

- Introduction
- What is the impact of the shock?
 - A fall in energy prices is usually illustrated by a fall in mark-up. This shifts the price-setting curve up and we're now in a deflationary period.
 - What is the central bank's preferred response?
 - A fall in interest rates to counteract disinflation.
 - What is the firms' preferred response?
 - A rise in mark-up to counteract disinflation
 - What are the workers' preferred response?
 - A rise in wages to counteract disinflation
- Is it important to consider income distribution in macroeconomic analysis?
 - Yes – it's important to factor how increases in wages could affect consumption. [Karsten paper](#)/Vildower et al.
 - Different shares will lead to different levels of consumption and investment in the economy.
 - Can lead to inequality can exacerbate shocks.
 - Can lead to radical politics.

