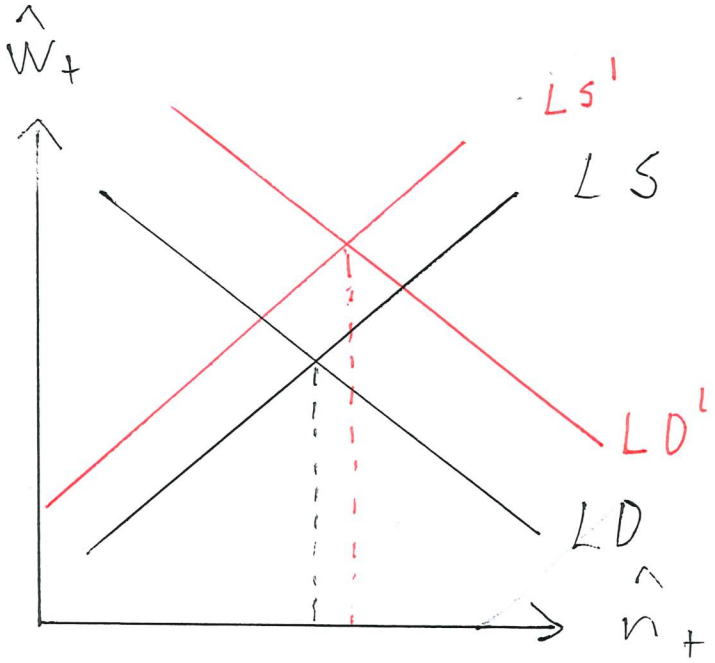
Lecture 2



LS: $\hat{w} = \hat{c} + \varphi \hat{n}_t$

LD: $\hat{w} = \hat{a} + \alpha(\hat{k}_t - \hat{n}_t)$

$\hat{a}$ ↑ : LD shift out

flatter LS, larger response of $\hat{n}_t$ (sub effect)

$\hat{a}$ ↑ → $\hat{c}$ ↑

larger $\hat{c}$ response, smaller response of $\hat{n}_t$ (income effect