231016 – Intro to the Short Run

Motivating Questions
Ch 9: How are short run output, inflation, and unemployment linked? Ch 11: What is the relationship between interest rates and short run output? Ch 12: How can a government use monetary policy to influence short run output? Ch 13: How do we link monetary policy rules to inflation and unemployment?
Output and growth in the long run are determined by:
Output in the short run is determined by:
Shocks describe:

Y_t	$\bar{Y}_t$	$\tilde{Y}_t$

$$\tilde{Y}_t \equiv \frac{Y_t - \bar{Y}_t}{\bar{Y}_t}$$

When $\tilde{Y}_t < 0$, the economy is in a ___________	When $\tilde{Y}_t > 0$, the economy is in an ______________

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Price cycle (2 versions)	
Demand version In good times, firms _________ prices Inflation then _________ Demand ___________ as prices ___________ Firms ______________ and hire _________ workers Inflation then __________ Demand _________ as prices ___________	Wage version In good times, firms hire __________ workers The labor market gets _______, and wages ________ Prices ________ in response to wages ____________ Demand __________ as prices __________ Firms hire ___________ workers The labor market gets _______, and wages ________ Prices ________ in response to wages ____________

Okun's Law

$$u - \bar{u} \approx -\frac{1}{2}\tilde{Y}$$

u	$\bar{u}$	$u - \bar{u}$	$\tilde{Y}$

Linking unemployment and Prices

High output ⇒ ____________ unemployment ⇒ ______________ inflation