The Self Adjusting Mechanism

AD

0

P0

5,000

4,000

$$AS(W_1)$$

P1

Potential GDP

$$AS(W_2)$$

Unemployment: Easy for firms to hire, workers accept lower wages

Wages fall

AS shifts

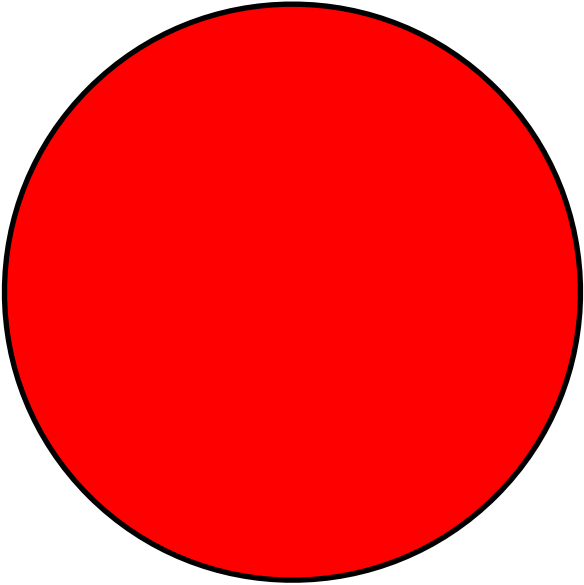
right

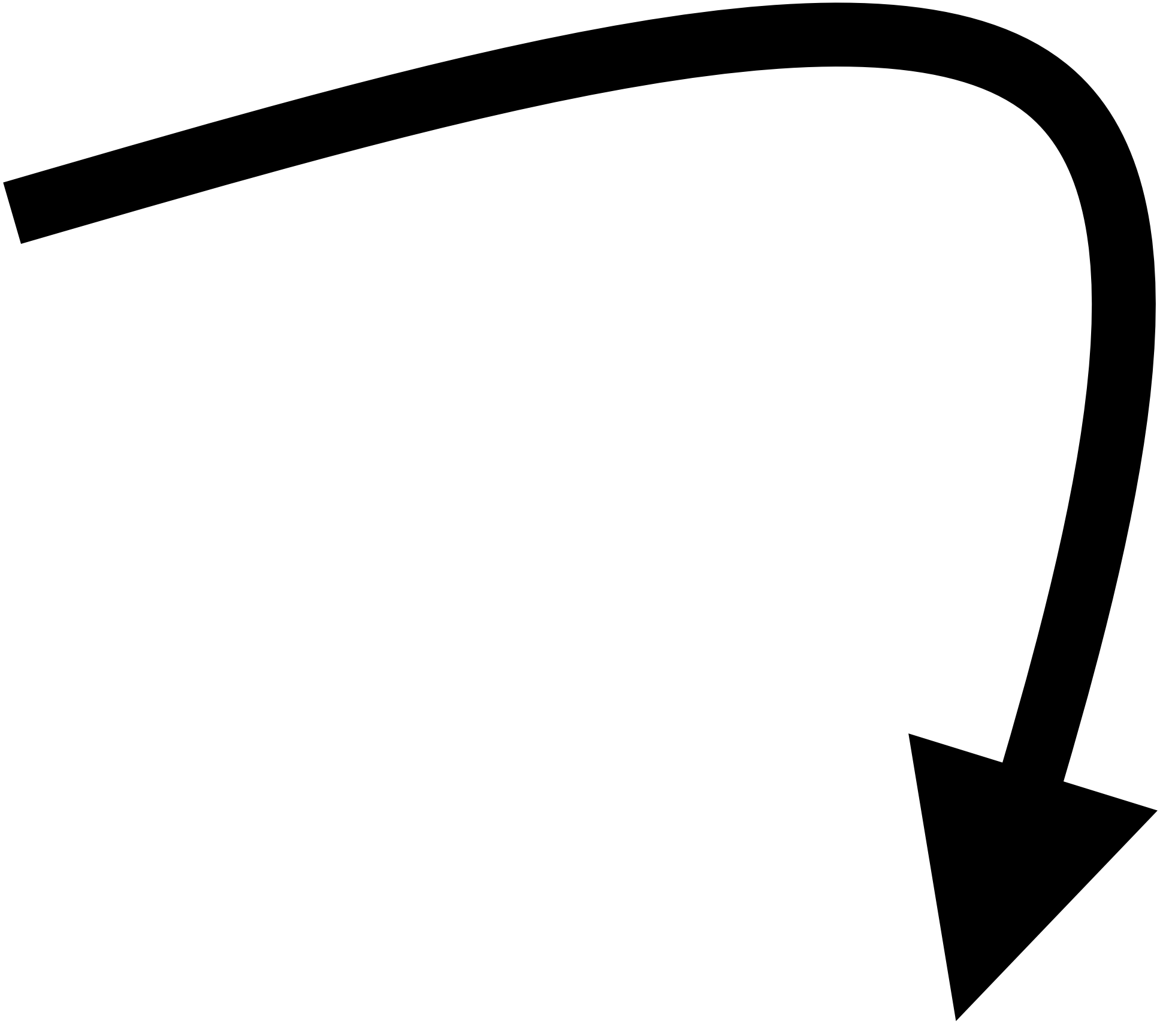
Prices fall, AD increases gap closes

Weak Demand is resolved by a decrease in prices

Unemployment cause wages to fall and then, prices fall

Recessionary Gap





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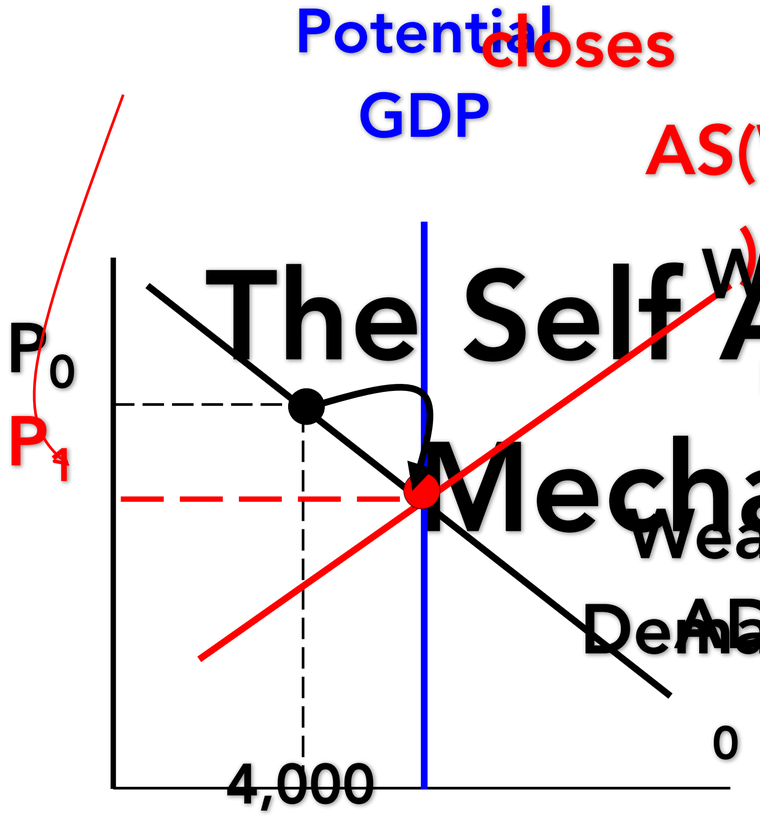
Weak Demand

The Self Adjusting Mechanism

Prices fall, AD increases gap closes



Weak Demand is resolved by a decrease in prices

Weak AD

Unemployment cause wages to fall and then, prices fall

Does the US economy has a self correcting mechanism?