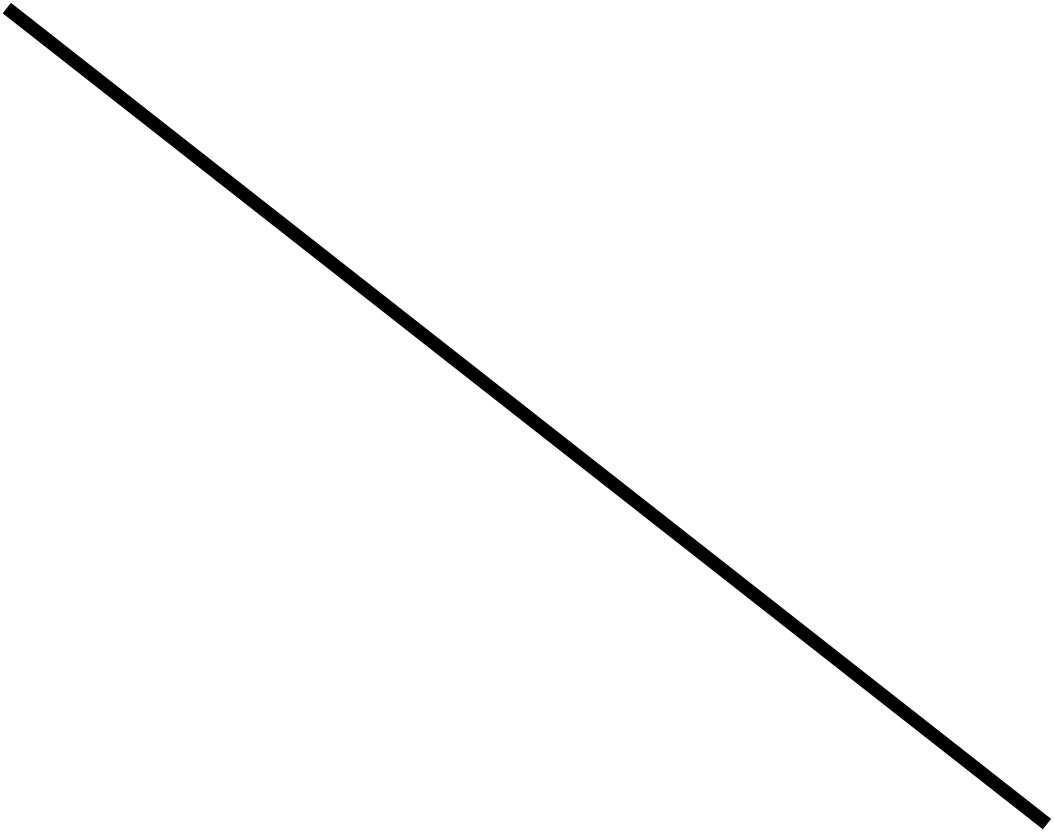


The Self Adjusting Mechanism







AD₀

P

O

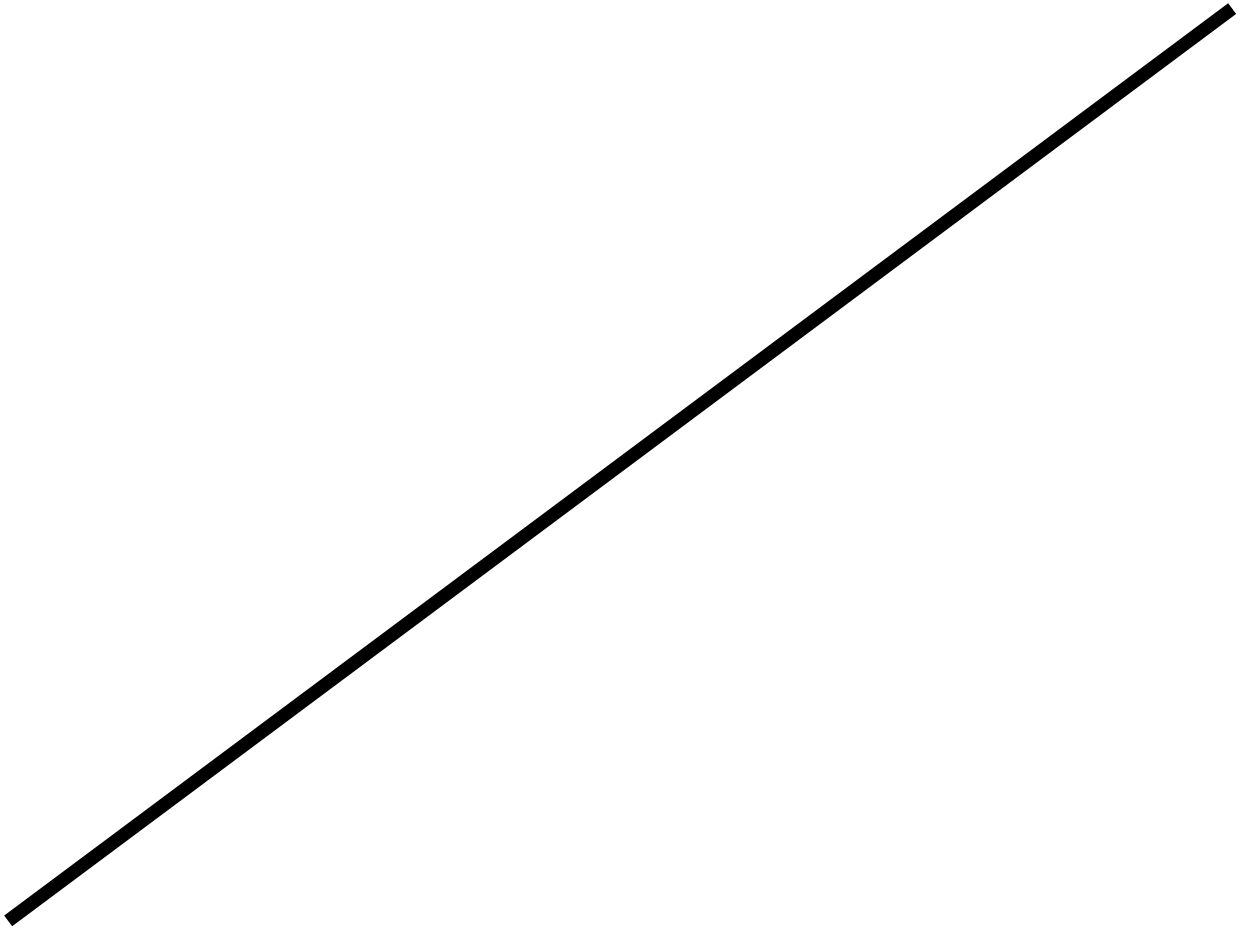


5,000

4,000







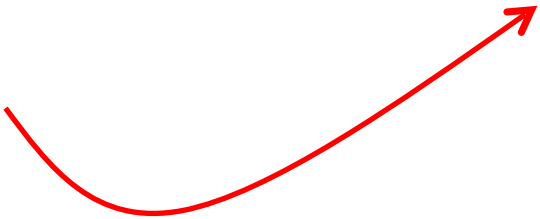
AS(W₁)

P

1

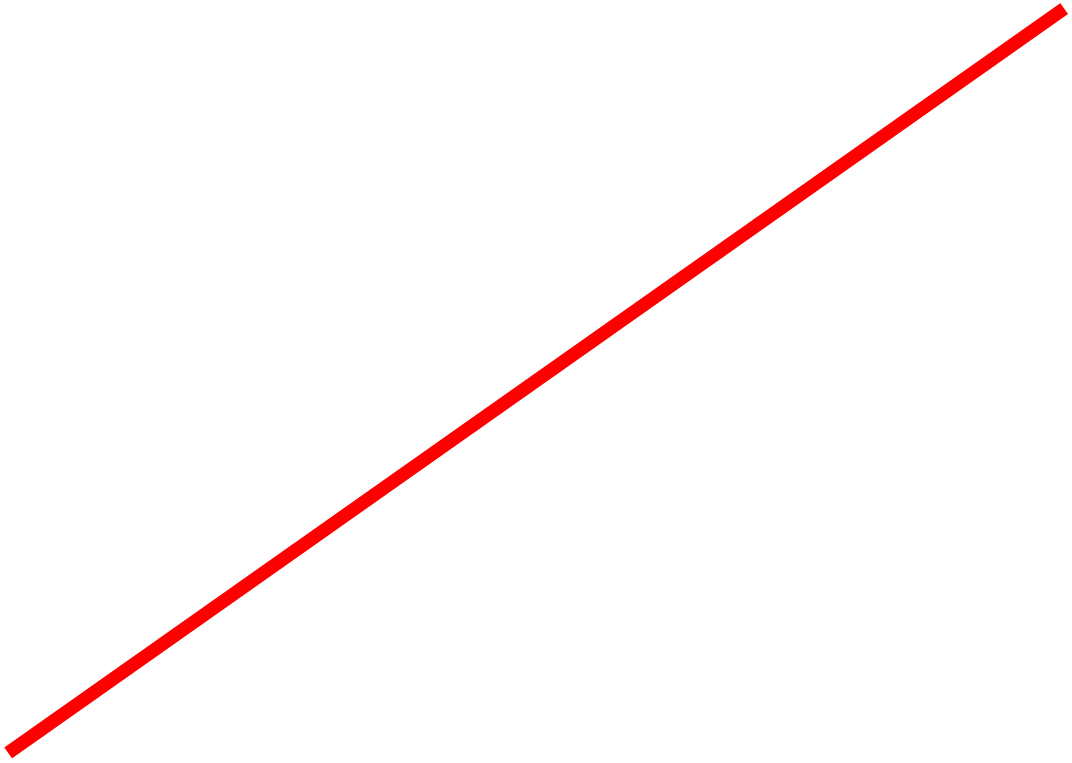
Potential
GDP





Inflationary Gap





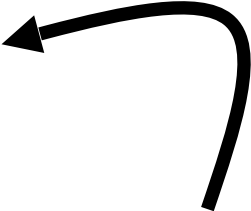
AS(M_2)

Labor market shortages:
Difficult for firms to hire,
easy for workers to win
wage increases

Wages rise AS

shifts left

As prices rise,
Aggregate Demand
decreases: gap
closes



Excessive spending
is eliminated by the
increase in prices





Labour shortages cause wages to rise

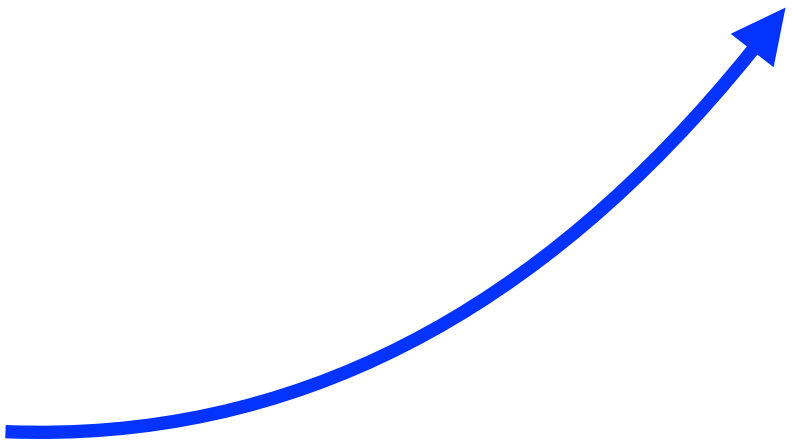
and then, prices rise

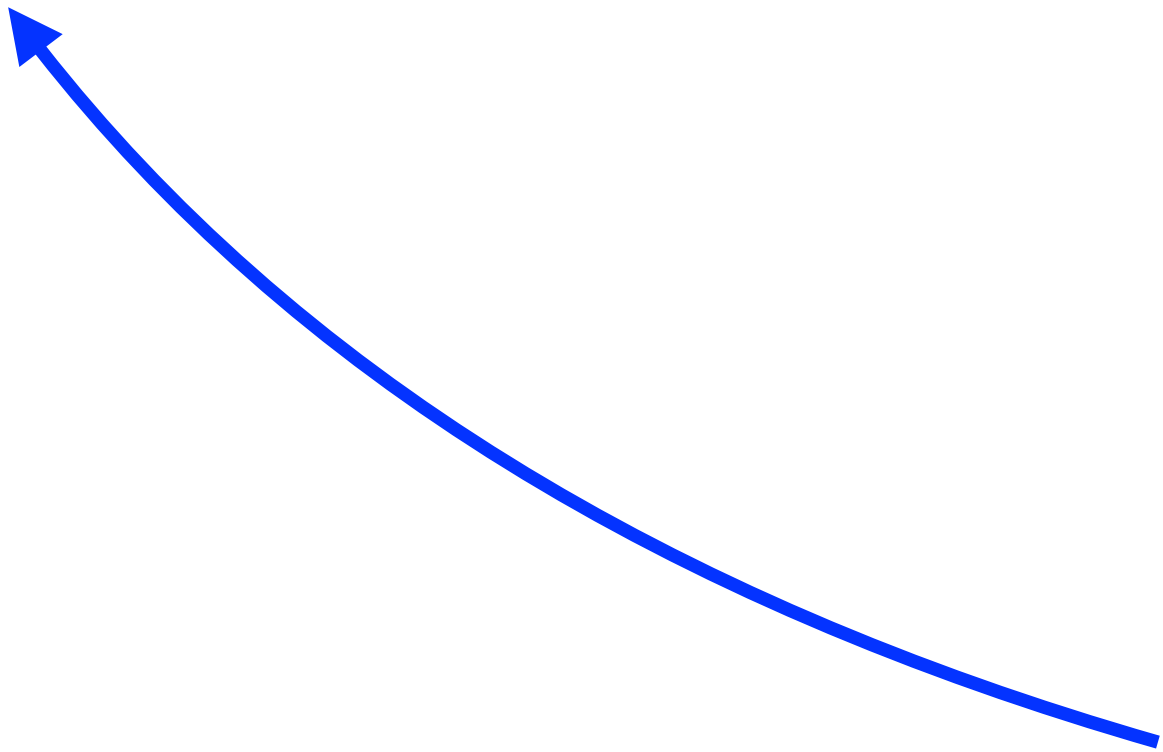
Excessive
spending







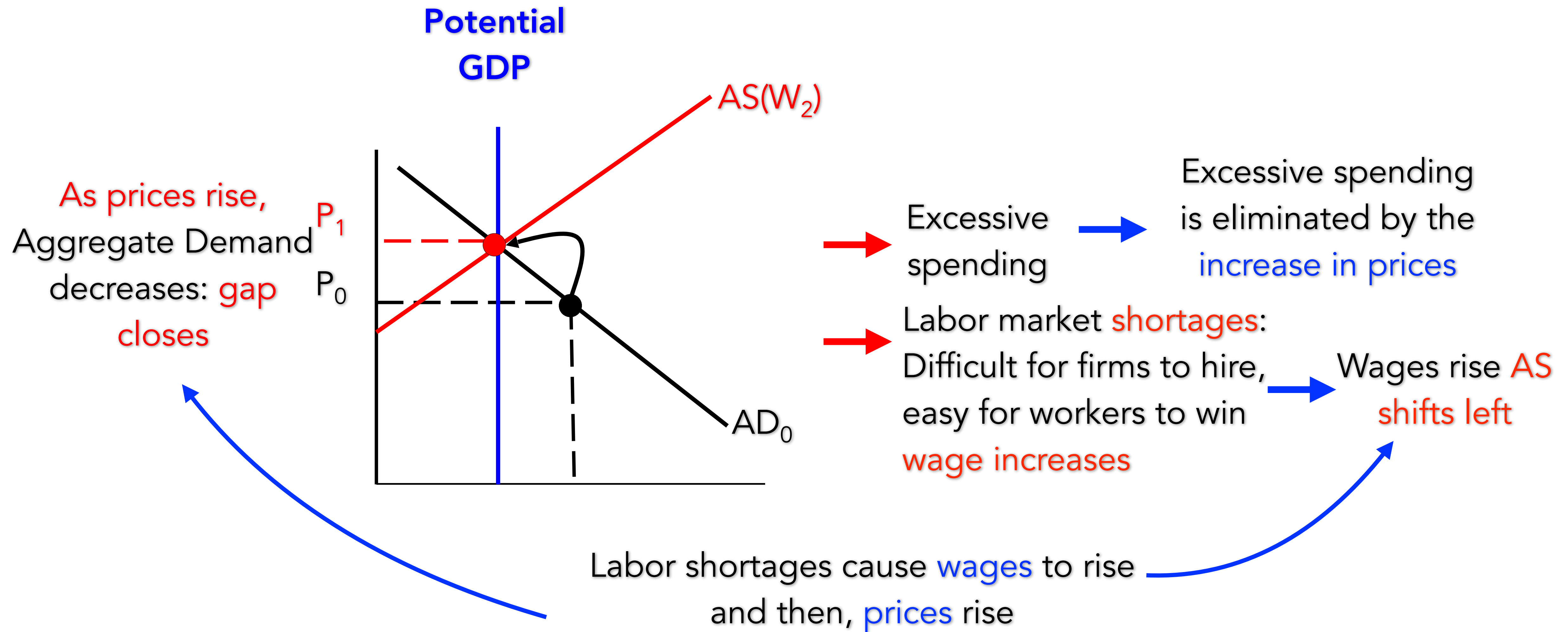






The *Self Adjusting* Mechanism works through
automatic changes in wages and prices

The Self Adjusting Mechanism works through automatic changes in wages and prices



The Self Adjusting Mechanism

