

AE

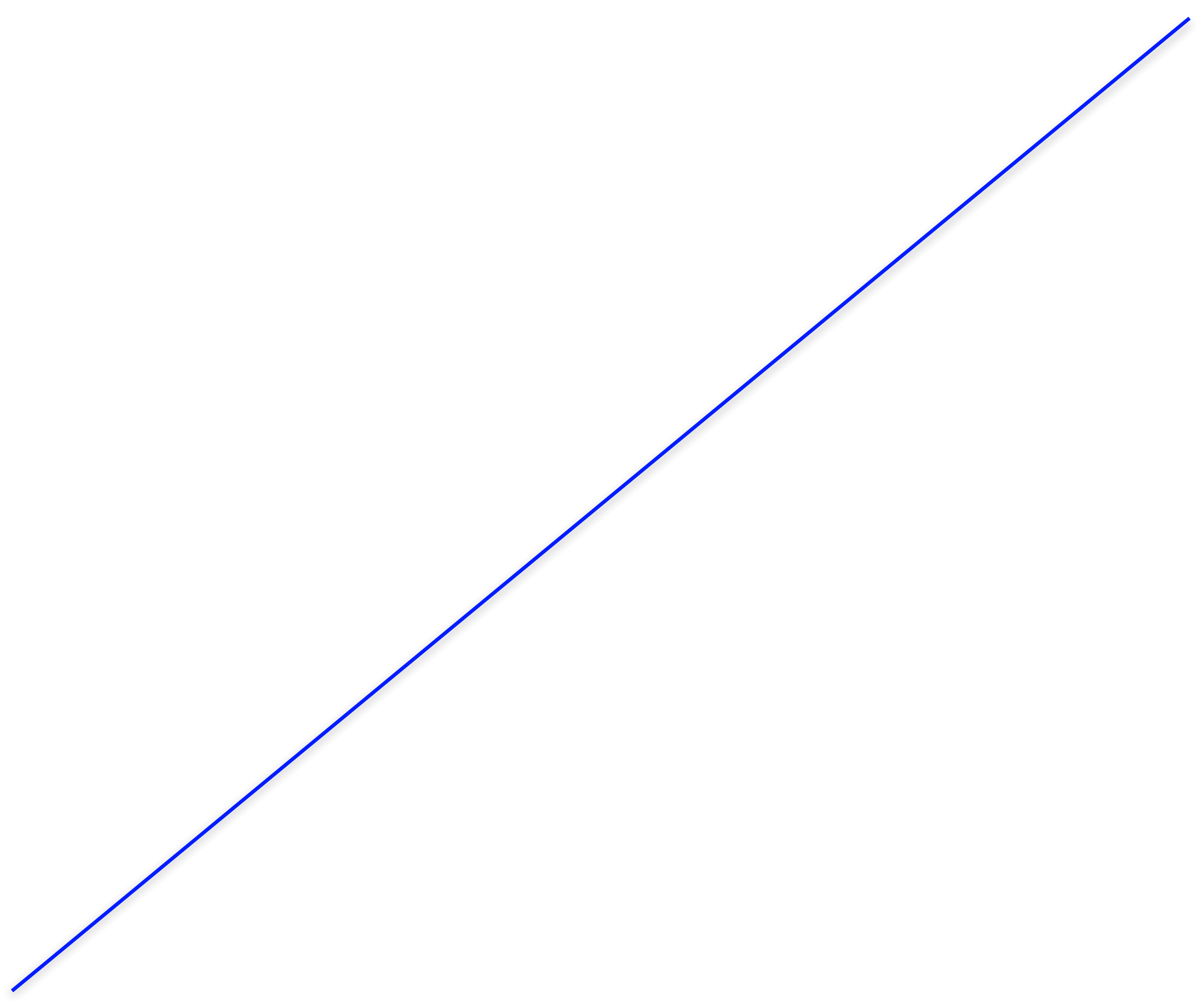


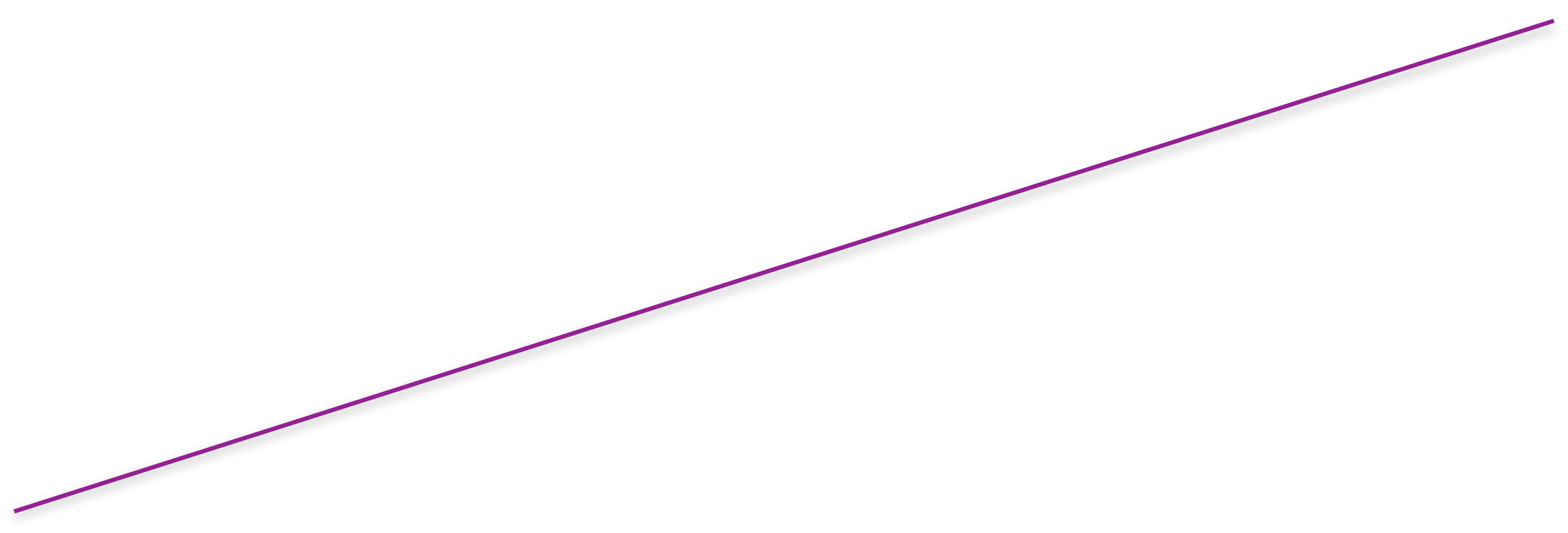
A

E

Total
Production









AE

=

Y*





Where the two lines cross: Total
Production is equal to Total
Sales AE

Firms will continue to produce Y^* quarter after quarter...

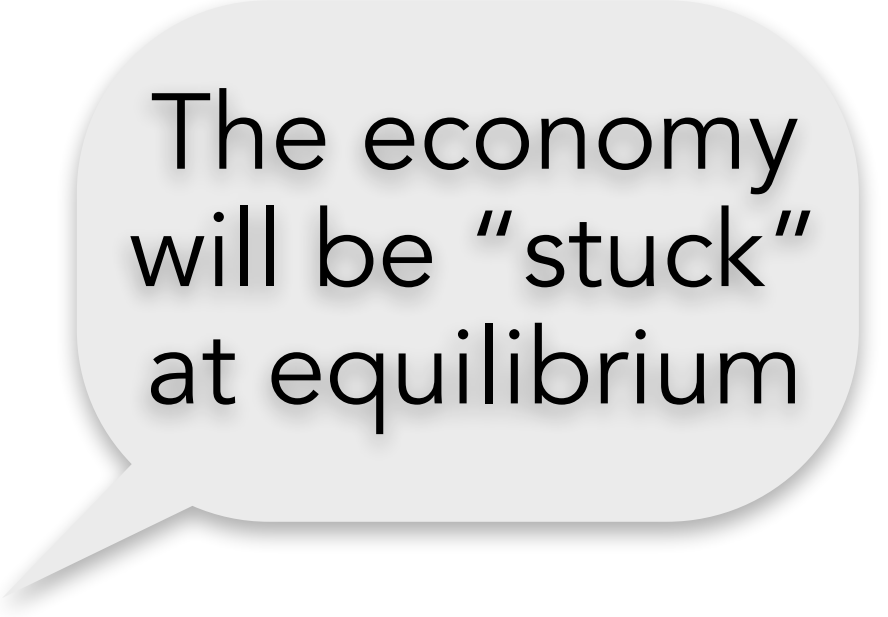
Equilibrium output may be "too low" with massive unemployment

Equilibrium output may be "too high" with rampant inflation

Equilibrium is **not** a happy place
where we want to be

Equilibrium output is what the economy will end up producing regardless of whether it is "too high (inflation)" or "too low (unemployment)"

When firms
produce Y^* the
economy is at
equilibrium

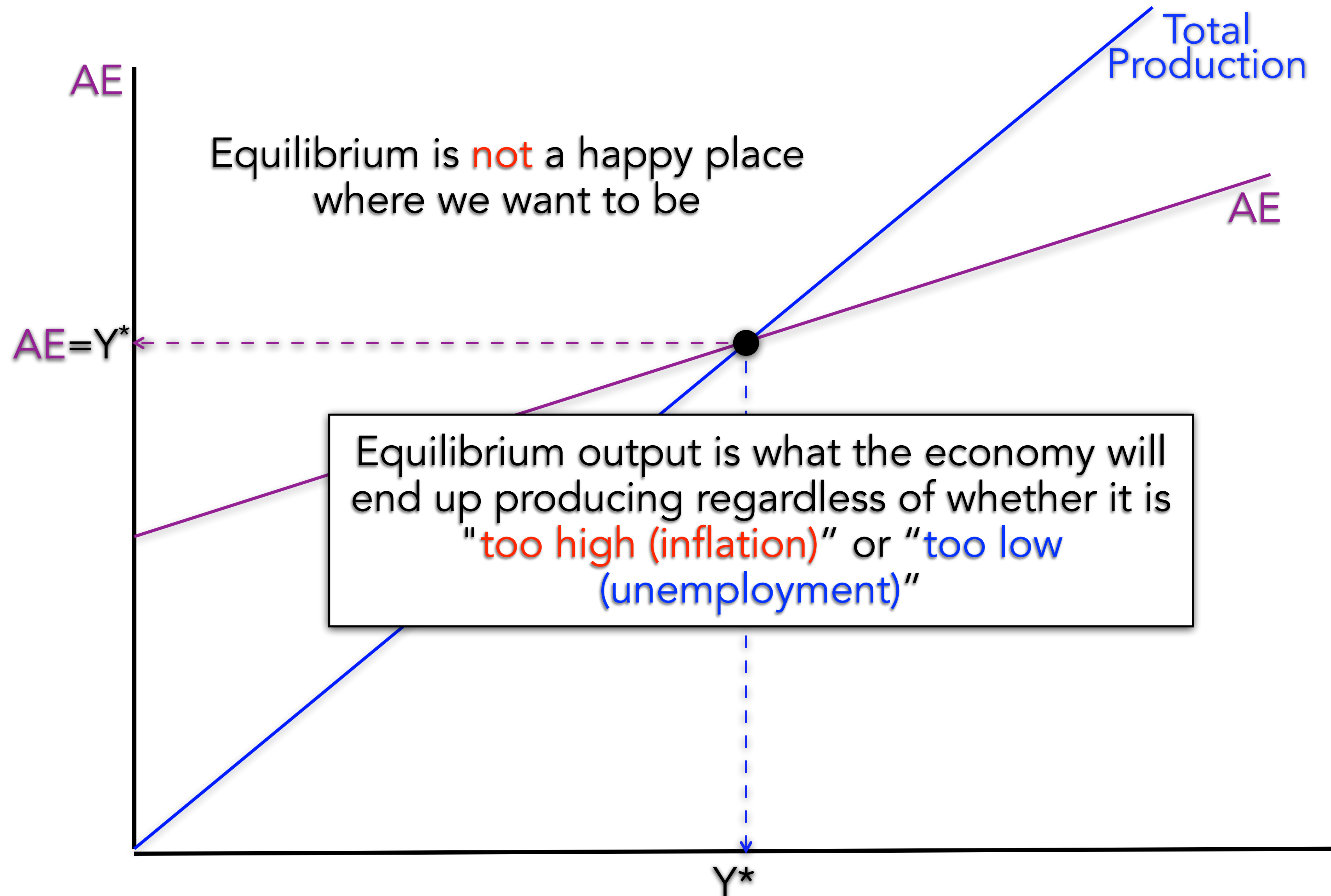


The economy
will be "stuck"
at equilibrium



No change in
inventories

Equilibrium output may be “too low” with massive unemployment



Equilibrium output may be “too high” with rampant inflation

