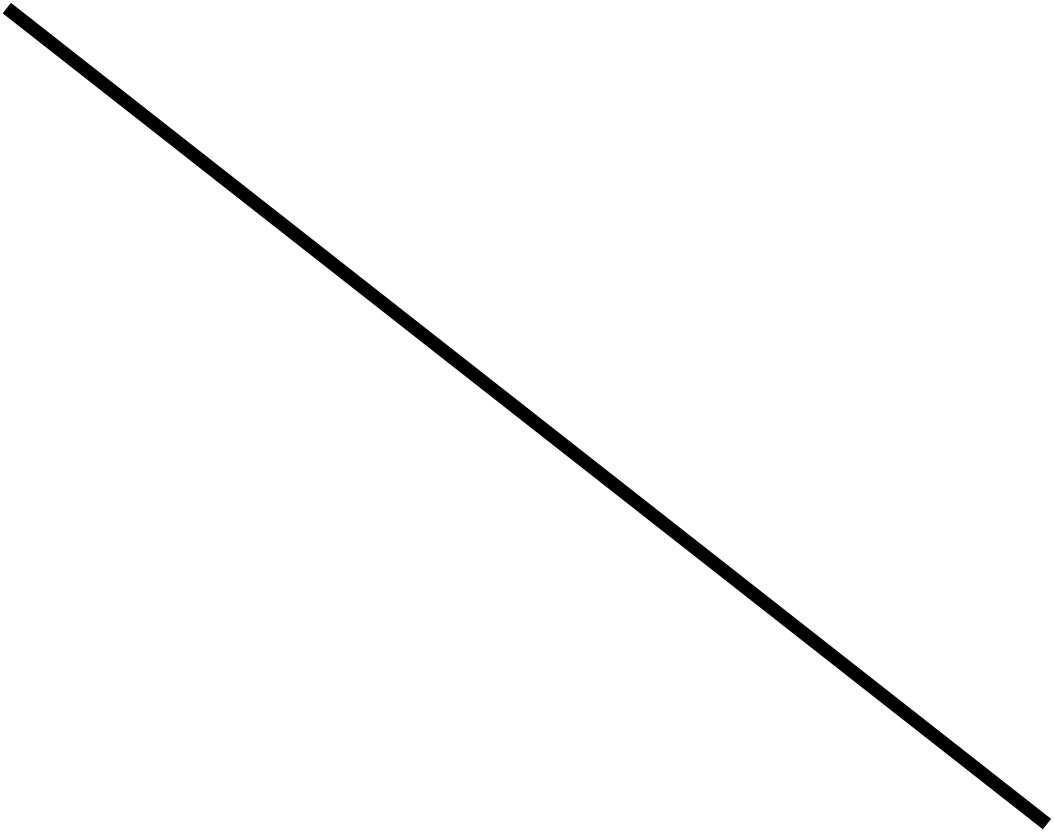


The Self Adjusting Mechanism







AD₀

P

O

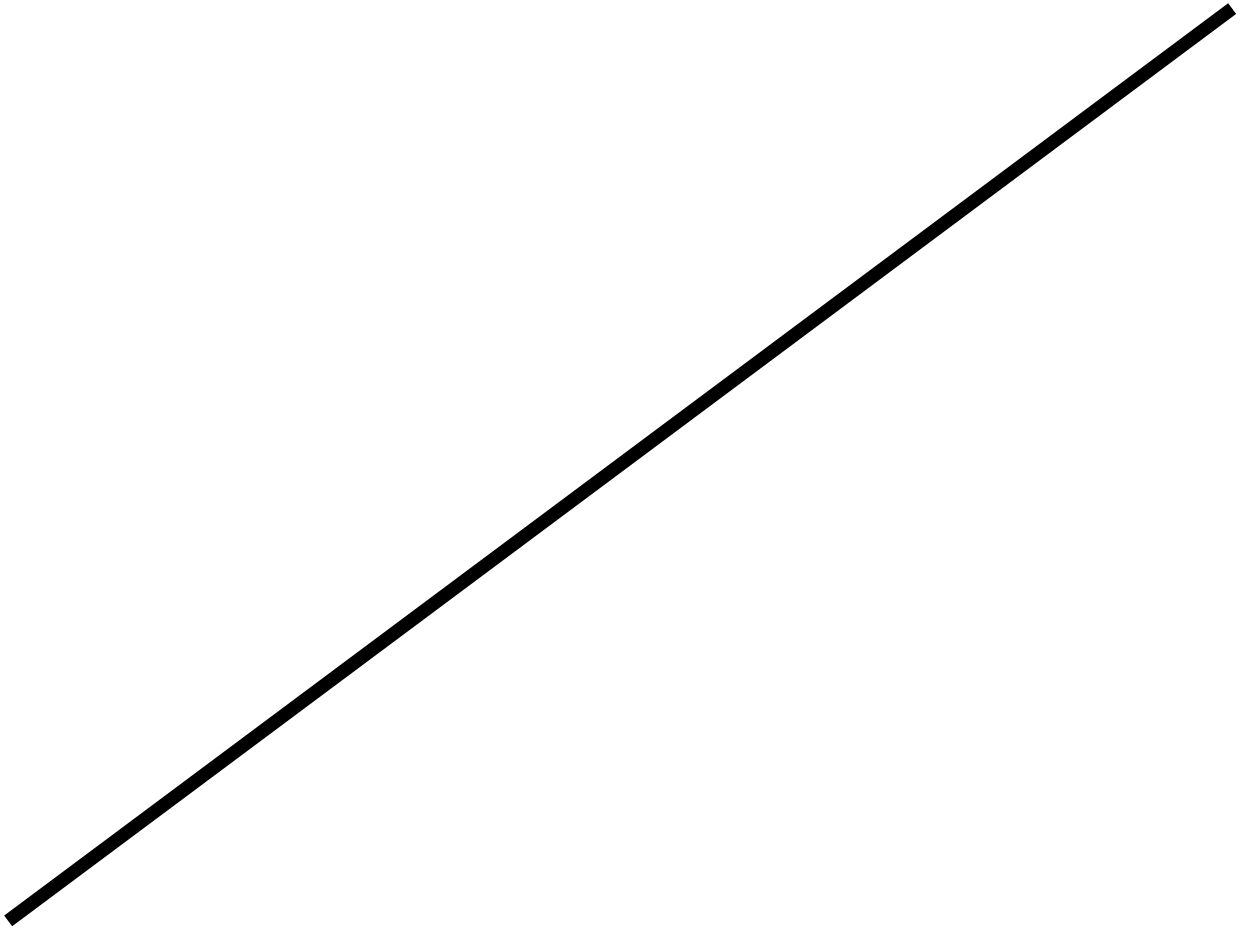


5,000

4,000







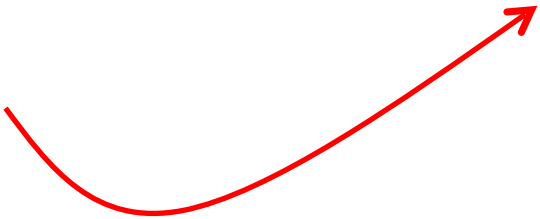
AS(W₁)

P

1

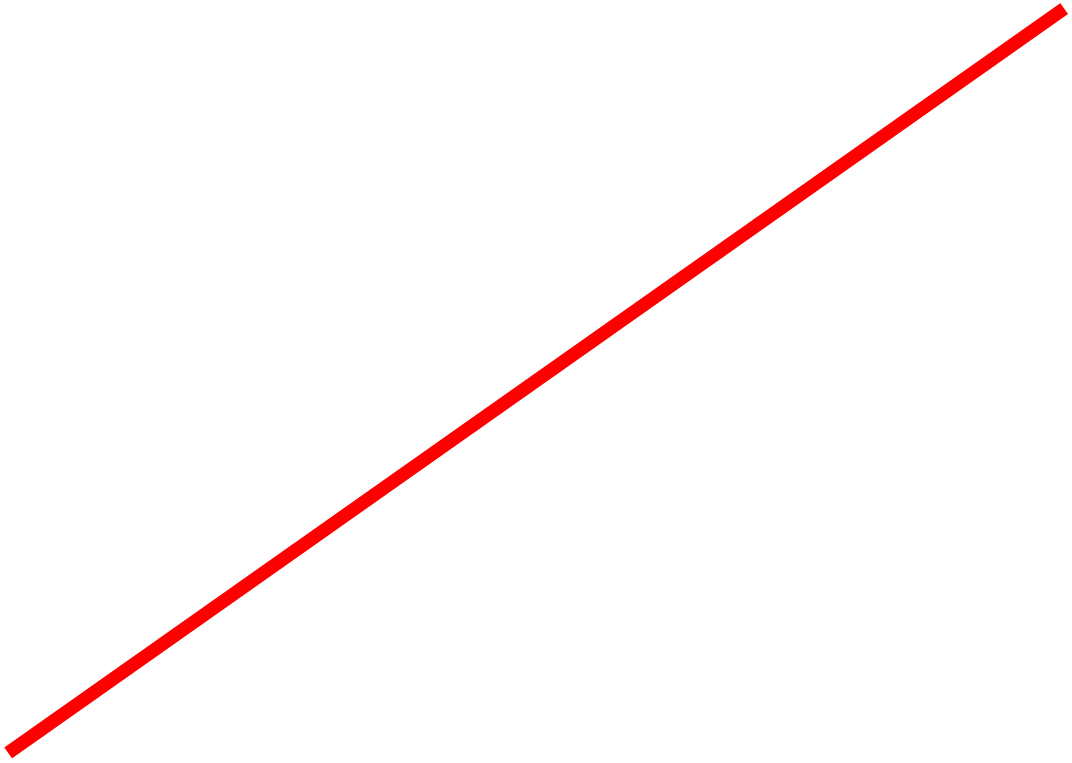
Potential
GDP





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

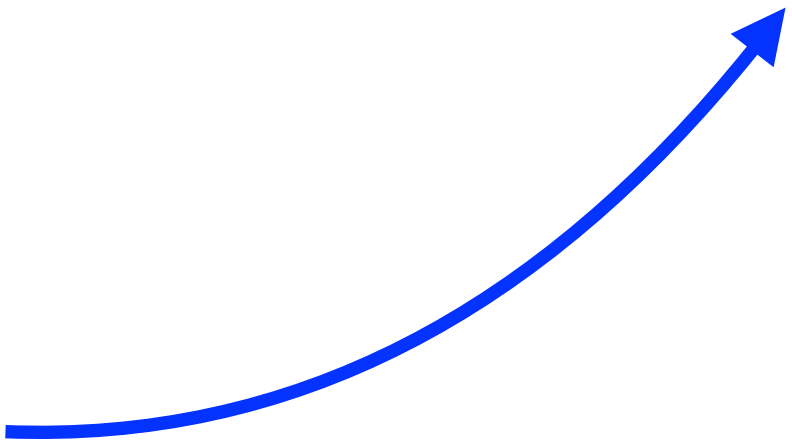
and then, prices rise

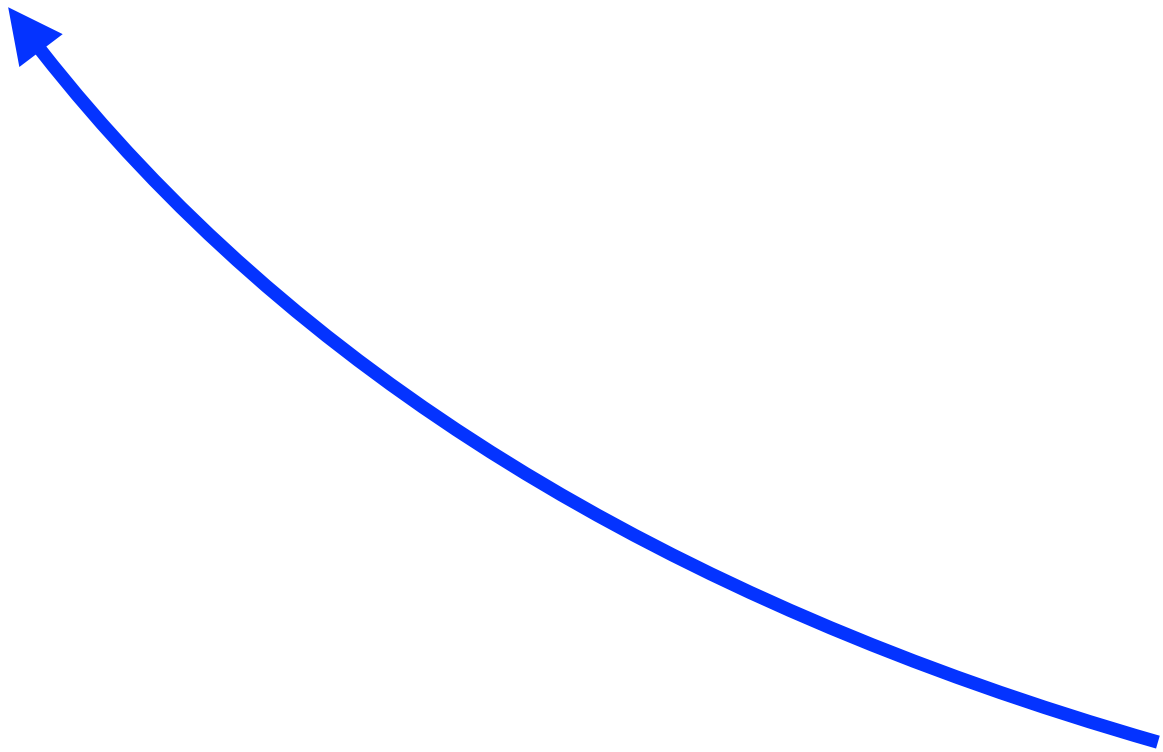
Excessive
spending













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

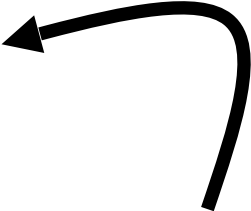


2



3

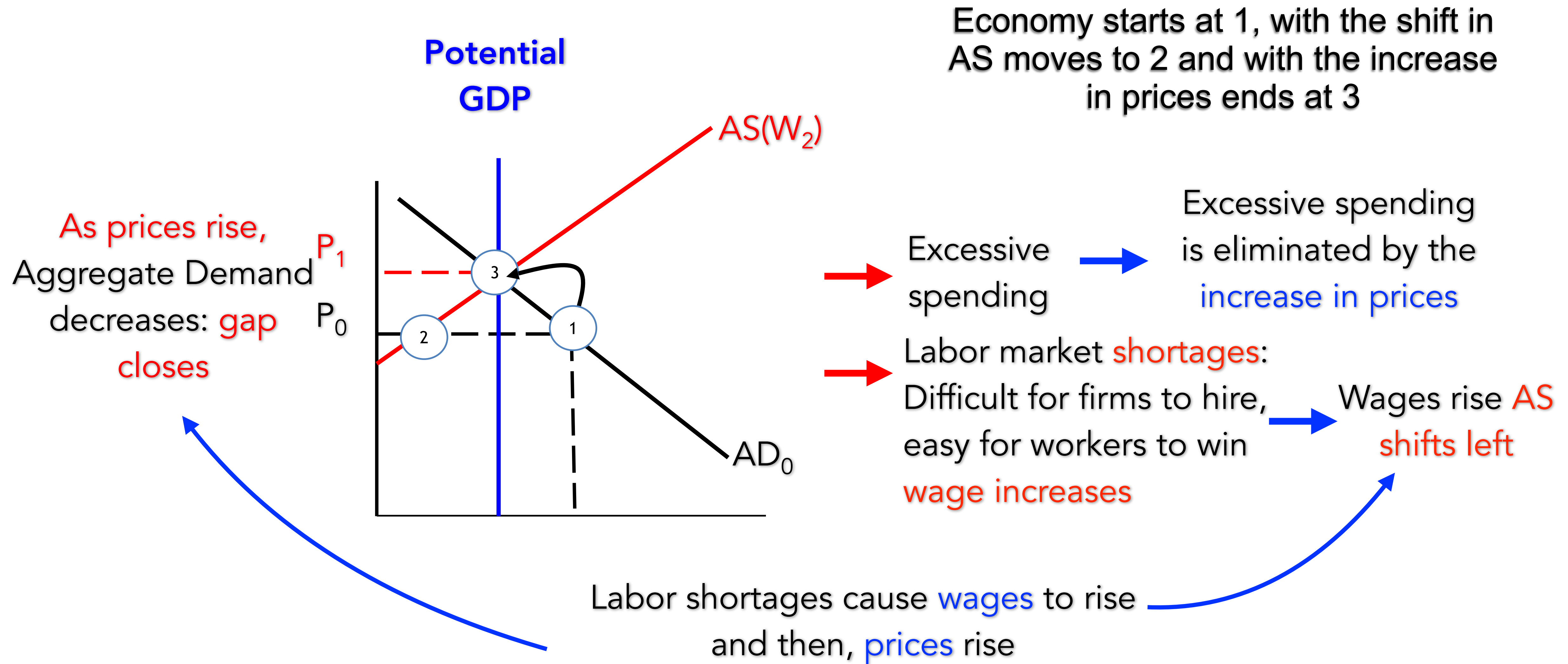
Economy starts at 1, with the shift in
AS moves to 2 and with the increase
in prices ends at 3





1

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



The Self Adjusting Mechanism

