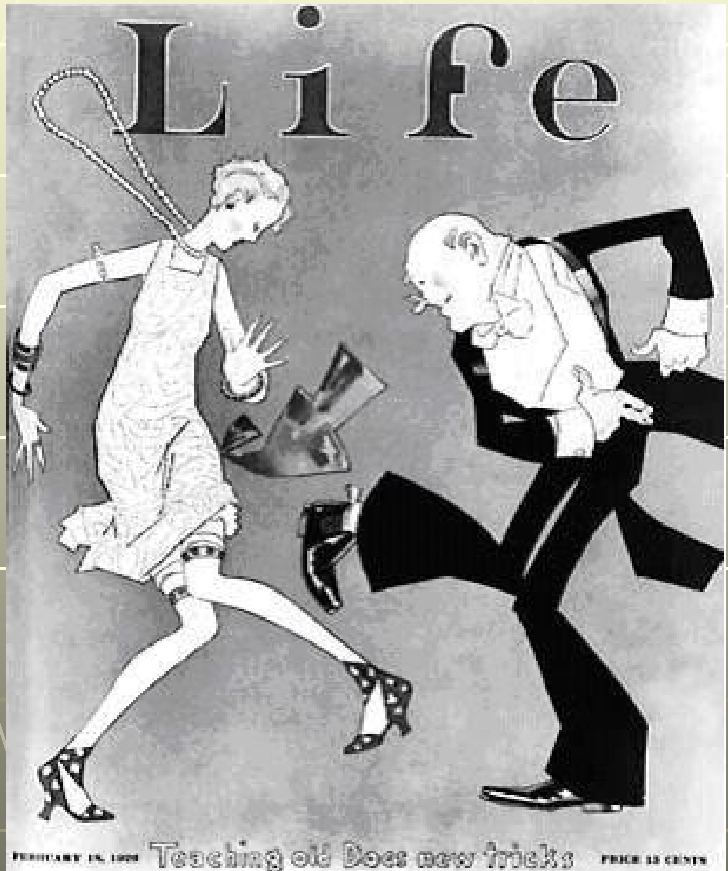
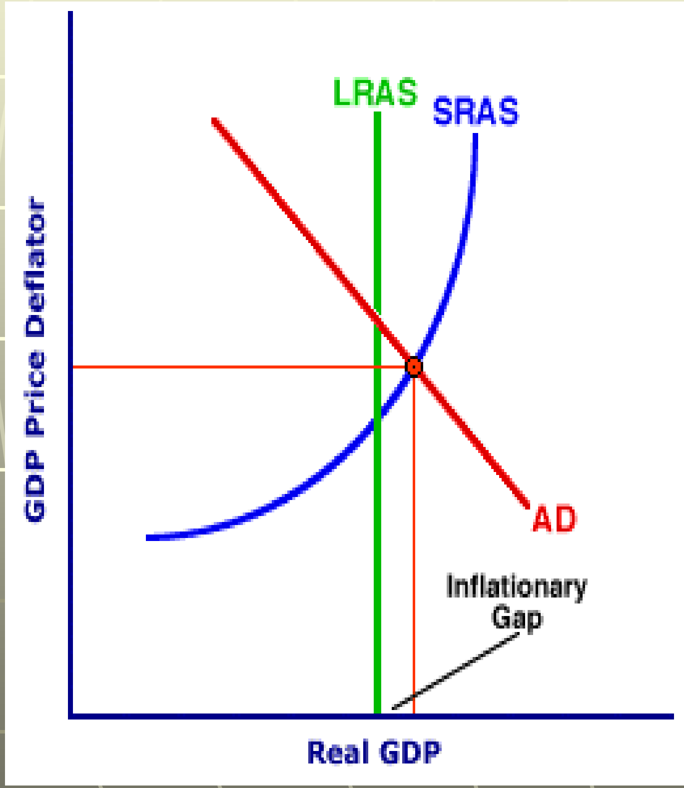
How MARKETS Adjust to Economic Phenomena


Life
Teaching old Dogs new tricks
PRICE 15 CENTS

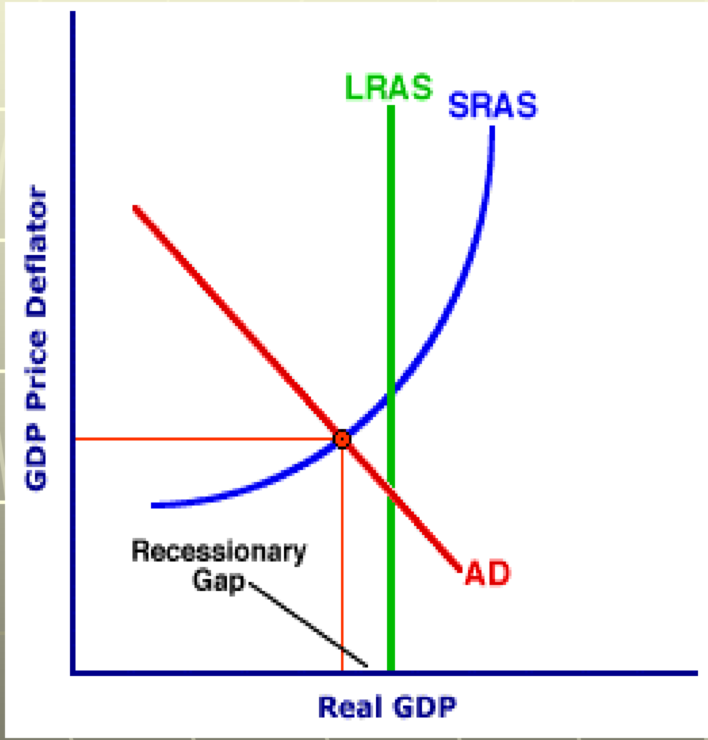
Market Adjusts to an Inflationary Gap



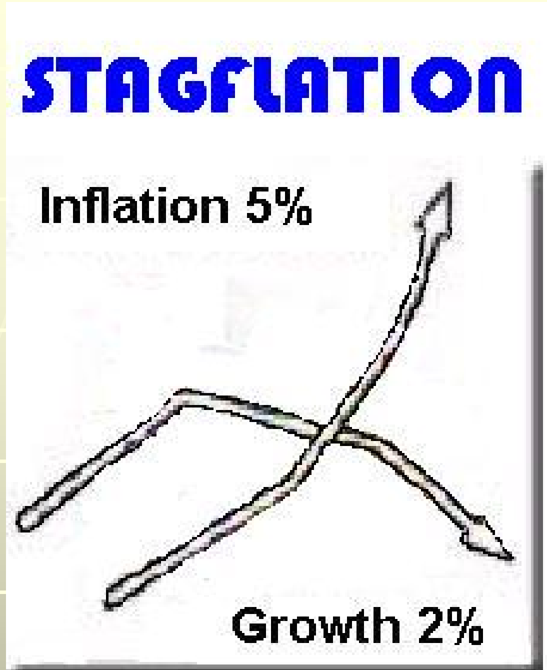
- AD is above full employment level (overutilization of factor labor and other factors of production in the SR)
- PL have increased / risen, but
- Nominal Wages are unchanged
- Value of DI declined (purchasing power of the employed has fallen) THUS:
- Employees will bargain for higher wages and salaries
- Due to positive economic development and high value of orders placed - employers grant increase in wages
- Nominal wages rise, Real wages will either return to or come at least close to pre-inflationary levels
- Cost of Production increases
- SRAS will decrease
- Economy moves back towards previous FE - Level, but with the result that
- PL have increased


2008
RECESSION

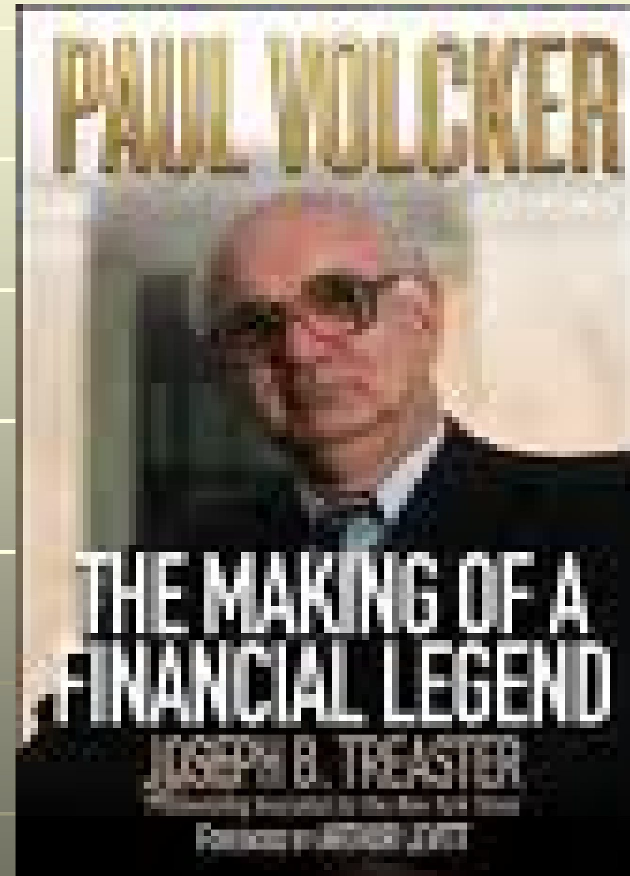
Market Adjusts to a Recessionary Gap



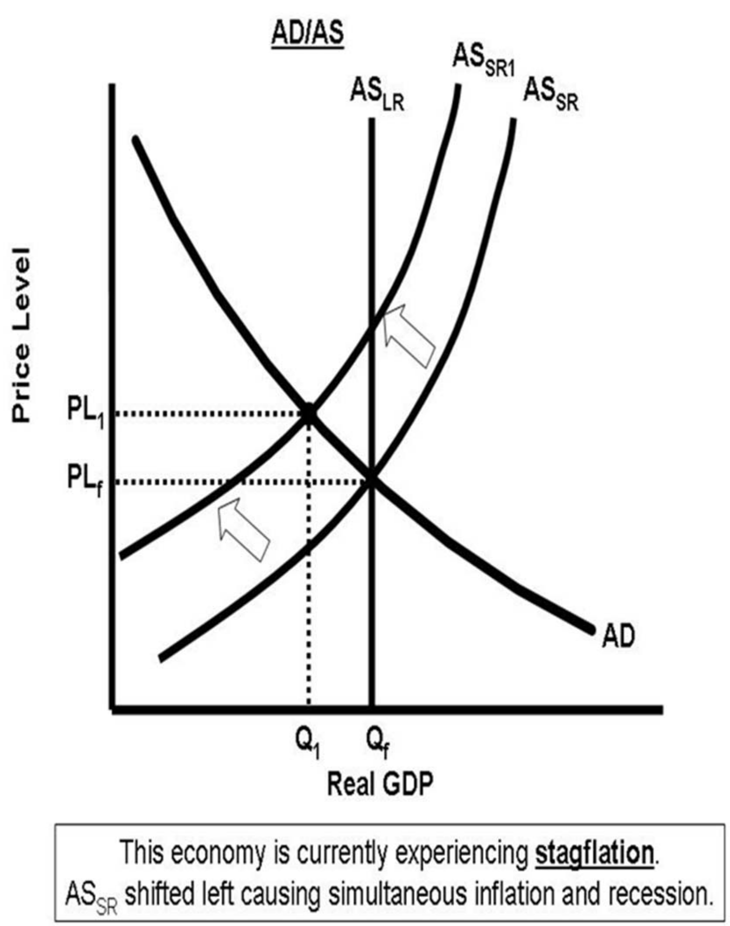
- AD is below full employment level (underutilization of factor labor and other factors of production in the SR)
- PL have decreased / fallen, but
- Nominal Wages of those still employed are unchanged
- Value of DI increased(purchasing power of the employed has risen) However:
- Employees fear job loses THUS: they will agree to lower wages and salaries and cuts in benefits
- Nominal wages decline, Real wages will either stay the same or decline somewhat depending on the ration between change in PL and change in Income
- Cost of Production falls
- SRAS will increase
- Economy moves back towards previous FE - Level, with the result that
- PL have fallen


STAGFLATION
Inflation 5%
Growth 2%


WHIP INFLATION NOW
WIN
Gerald R. Ford • 1974


PAUL VOLCKER
THE MAKING OF A FINANCIAL LEGEND
JOSEPH B. TREASTER

Market Adjusts to Contractionary Gap (Stagflation)



SRAS is below full employment level (underutilization of factor labor and other factors of production)

PL have risen, but

Nominal Wages are unchanged

Value of DI declines (lose in purchasing power of salaries and wages) BUT

Employees fear unemployment and will therefore agree to lower wages, even though PL have increased

Nominal wages decline

Therefore costs of production decrease

SRAS increases

Economy moves back toward FE – Level & PL will decrease

Nominal wages are unchanged(neither additional decline nor an increase), Real wages however might see an increase due to the gained purchasing power (depending on change in PL and progressive income tax effect)