CONCEPT: SHIFTS IN SHORT-RUN PHILLIPS CURVE AND EXPECTED INFLATION

- Two of the main macroeconomic concerns for policy makers are ***unemployment*** and ***inflation***
  - □ However, it is hard to control both at the same time!
  - □ The position of the short-run Phillips Curve is related to ____________ inflation

$$Real\ Wage = \frac{Nominal\ Wage}{Price\ Level}$$

The ***real wage*** (purchasing power) adjusts the amount of dollars you are actually paid for the price level in the economy
- (i.e. The same nominal wage will buy less stuff at higher prices)

If workers and firms expect a certain level of inflation (say 1.5%), but a higher inflation rate occurs (say 4.5%):

Expected Real Wage _____ Actual Real Wage

Firms will hire _______ workers leading to ________ unemployment

Price Level _____ and Unemployment ______, but ONLY because the inflation was ________________

If the new inflation rate (i.e. 4.5%) persists, it becomes the expected level of inflation →Shifts the SR Phillips Curve

Rational Expectations Theory – when forecasting the future, people use all publicly available information
- In this case, people are making rational decisions about the level of expected inflation

Long-Run Phillips Curve