EE312 Macroeconomics, 2/2017 (Sec. 046402 - Sicha) : Ch4, Supplement

Example 1. Assume an economy has the short time Phillips Curve that is defined by $\pi_t = \pi_t^e + 0.12 - 2u_t$ and $\pi_t^e = \theta\pi_{t-1}$

- What is the natural rate of unemployment?

1. Assume that $u^* = 0.06$, $\pi_t^e = 0$ for all t. $u_0 = 0.06$ and $\pi_0 = 0.06$.
   (a) What are π_t, π_{t+1}, π_{t+2} and π_{t+3}? Comment on the results.
   (b) At time t, the policymakers keep $u_t = 0.04$ forever. What are π_t, π_{t+1}, π_{t+2} and π_{t+3}? Comment on the results.
2. At time t, the policymakers keep $u_t = 0.04$ forever. What are π_t, π_{t+1}, π_{t+2} and π_{t+3}? Comment on the results.
   (a) Assume that θ is equal to 0. At $t-1$, $u = u^*$.
   (b) Assume that $\pi_{t-1} = 0$, and $\theta = 1$.
   (c) Assume that $\pi_{t-1} = 0$, and $\theta = 0.5$.

Example 2. Suppose the expected inflation rate is unchanged, the natural rate of unemployment falls. What will happen to Phillips curve?

Example 3. Suppose the natural rate of unemployment is unchanged, the expected inflation rate falls. What will happen to Phillips curve?