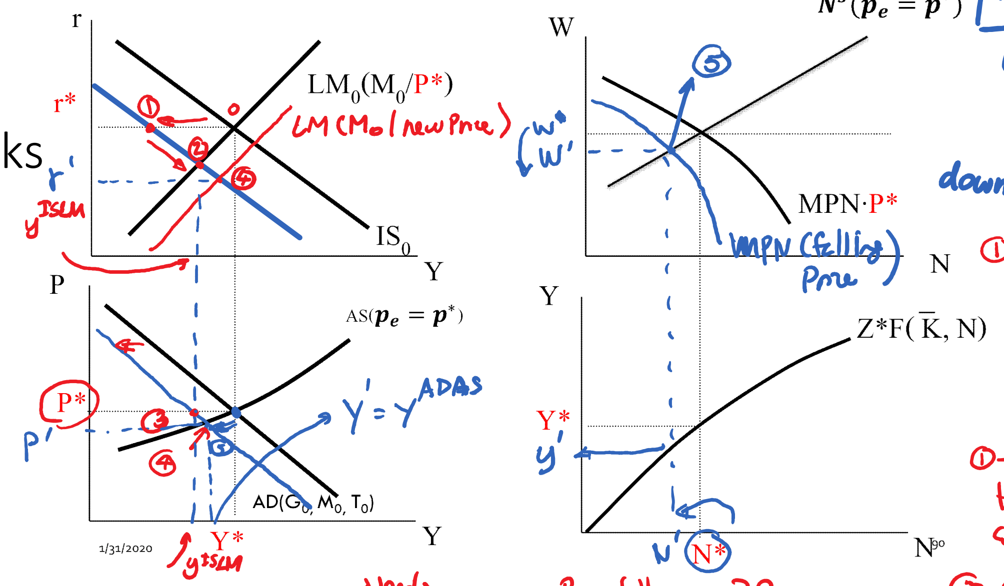
Friday, January 31, 2020 1:24 PM

→ uncertainty → Investment ↓ or consumption ↓

Assuming we start at y^* (full employment)

Negative IS shocks

Friday, January 31, 2020
10:28 AM



$\boxed{\text{Negative IS shocks}}$ → downturn in Business Cycles

↳ Mechanism
how shocks "spillover"
the Effect to generate
downturn ~~downturn~~ (or recession)

① fixed "r" respond to "Y" to negative IS shocks
horizontal direct 0 → 1
capture Multiplier Effect
under DAE assumption

① → ② Effect of falling "r"
that helps partially
stimulate the shortfall of AE.

③ Represent the decrease of AD for the fixed initial Equilibrium price p^*

at p^* after the Effect of Negative IS shock
was taken into account ⟹
⟹ 'Exess Supply' in the Market

Price falls ⟹ ??
stimulate Demand
Price fall ⟹ M^s/p ↑
↳ r ↓ → C ↑; I ↑
↳ y^d increase

Price fall ⟹ negative Effect on
Supplier → VMP ↓ ⟹ Labour demand
drops → firms hire less ppl → cutting production

Outcome
Is shocks
y drops
p drops
r falls
w falls
C, I } fall

The size of Contraction would be
Larger under fixed "r" and fixed "p"

"less severe Recession"

Impact of shocks get less strong
If the Economy can self-adjust
on ~~its~~ its own.