Economics 314 Spring 2020
Daily Problem #34 April 13

Menu-costs, augmented by real rigidity, are successful in modeling price stickiness, or price inertia. However, they are less effective at modeling inflation inertia—the tendency of inflation to continue even after the end of the aggregate-demand expansion that caused it.

1. Intuitively, why can the Taylor and Calvo models not explain why inflation would tend to continue even after aggregate demand stops expanding?

2. In the new Keynesian Phillips curve, $\pi_t = E_t\pi_{t+1} + \kappa(y_t - \bar{y}_t)$ or $\pi_t - E_t\pi_{t+1} = \kappa(y_t - \bar{y}_t)$, output booms occur when inflation is _____.

3. In a "backward-looking" Phillips curve model, $\pi_t = E_{t-1}\pi_t + \kappa(y_t - \bar{y}_t)$ or $\pi_t - E_{t-1}\pi_t = \kappa(y_t - \bar{y}_t)$, output booms occur when inflation is _____.