

Derivation of the PC curve:

Start with Equation (4) of the Derivation of the AS Curve Handout*

$$(1) P_t = p_t^e + p_t^e \left[\frac{A^e}{A} (2\alpha u_n - (1+m_0)\alpha - (\delta+z)) \right] (U_t - U_n)$$

This can be rewritten as:

$$\left[\frac{P_t}{P_{t-1}} - 1 \right] = \left[\frac{p_t^e}{p_{t-1}^e} - 1 \right] + \frac{p_t^e}{p_{t-1}^e} \left[\frac{A^e}{A} (2\alpha u_n - (1+m_0)\alpha - (\delta+z)) \right] (U_t - U_n)$$

$$\text{we will set } \lambda = \frac{p_t^e}{p_{t-1}^e} \frac{A^e}{A} [2\alpha u_n - (1+m_0)\alpha - (\delta+z)]$$

so that $\lambda > 0$. which yields:

$$(2) \pi_t = \pi_t^e - \lambda [U_t - U_n]$$

for the simpler Alet PS curve
 $\lambda = \left(\frac{A^e}{A} \right) \cdot \alpha$ which for $A^e = A$
is simply α which is what
is in the text and in the
Inflation Model Handout.

* It is only on Moodle; it was not handed out in class