Phillips Curve Assessment Activity *(Answer Key)* **Name____*(Teacher Version)*____**

Have your students complete this brief worksheet reflecting their understanding of the Phillips Curve. Please have them circle their answer and/ or write it in the space provided below.

1. Assume that the natural rate of unemployment is 6% and the actual rate of unemployment is 8%. What does the model predict will happen to prices?
Prices will INCREASE/*DECREASE* (circle one). Explain your answer.

[Prices will increase. In this model, the tradeoff between unemployment and inflation gets worse. The natural rate or "NAIRU" arises because when actual unemployment is below it, inflation accelerates. Thus, prices will increase.]

2. If the government tries to hold unemployment below its natural rate, workers will demand higher wages. Suppliers will respond by raising their prices. What is the name of this cycle?

[Wage-Price spiral.]

3. In the early 1960s, workers expected prices to remain constant. Around 1965, price increases were expected by workers. How did rising prices influence the wages workers demanded?

[Workers asked for wage increases. This resulted in a wage-price spiral.]

4. According to the Phillips Curve, inflation will not accelerate when the economy is at full employment. *TRUE* or FALSE (circle one). Explain your answer.

[TRUE. Workers expect prices to be the same as last year. There is no price pressure because of increasing wages.]

5. The Phillips Curve is negatively sloped. The Phillips Curve shows an inverse relationship between inflation and unemployment. *TRUE* or FALSE (circle one). Explain your answer.

[TRUE. High rates of unemployment are associated with low rates of inflation.]

6. From the Phillips Curve, one can determine the natural rate of unemployment - the point where inflation rate is constant. *TRUE* or FALSE (circle one). Explain your answer.

[TRUE. Since the economy is in long-run the inflation rate is constant. NOTE: the inflation rate is positive, but unchanging. Workers then correctly predict next year's prices as this year's prices.]