MARKETS : Exercise 3 23/10/0

Consider a market where

$$y_t = s(p^e_t) \qquad s' > 0$$

$$x_t = D(p_t)$$

i.) If price expectations are formed naively $p^e_t = p_{t-1}$ show ~~dem~~ what can happen if a demand shift takes place, giving a stable and an unstable market

ii.) Consider

$$y_t = a + b p_{t-1}$$

$$x_t = \alpha - \beta p_t$$

derive the stability condition and relate to the diagramatic exposition in ~~the~~ part i

iii.) Consider expectations being formed adaptively

$$p^e_t - p^e_{t-1} = k(p_{t-1} - p^e_{t-1}) \qquad 0 < k < 1$$

Will the market converge to an equilibrium after a demand shift?

iv.) Consider the implications of expectations being formed rationally