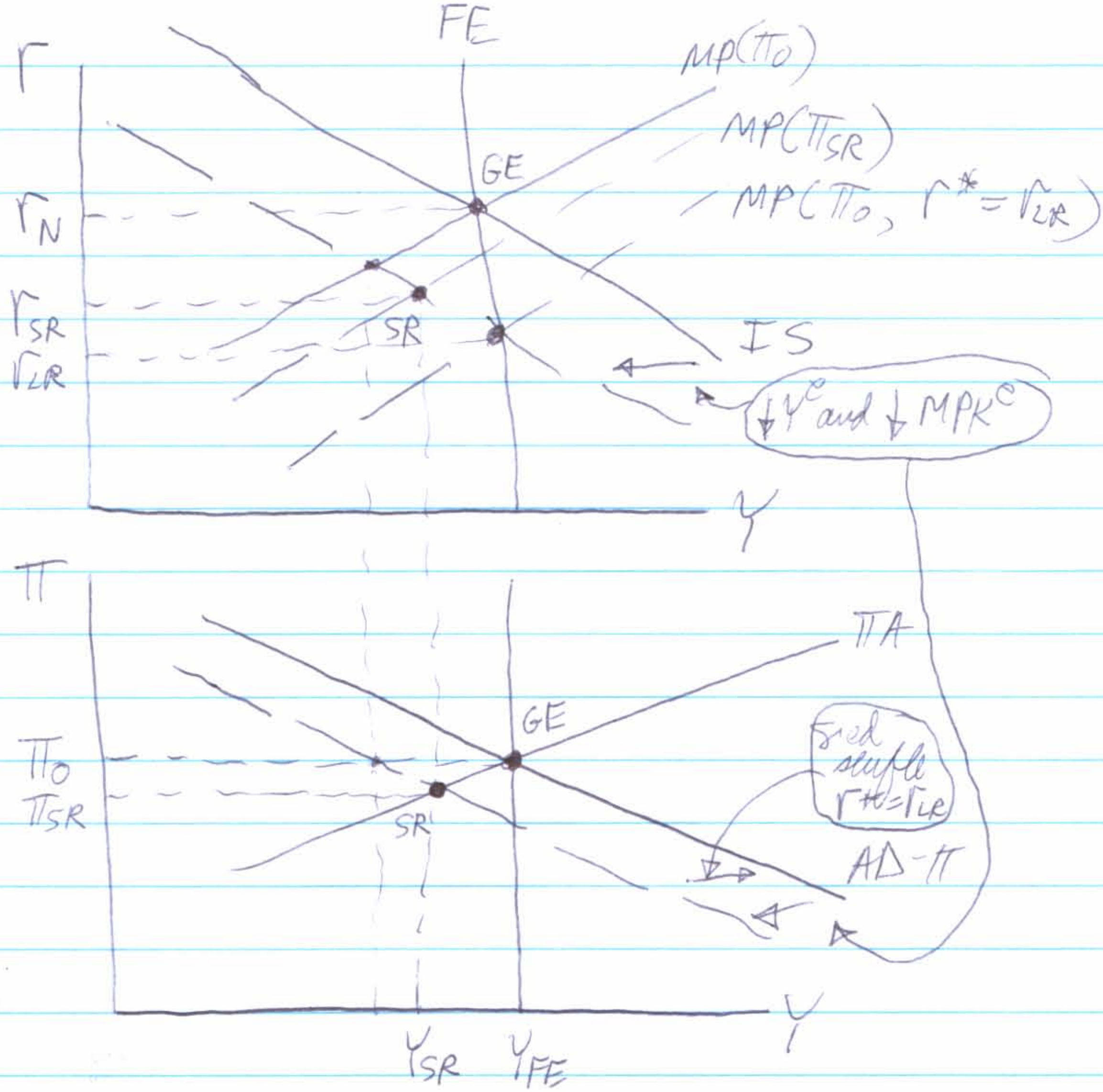
HW Q. How does the Fed keep economy out of recession when Y^e and MPK^e fall?



So in SR, pessimism on the part of firms + consumers shifts the IS left and AD-π left + movement along πA lowers π in SR. Y and r also fall in SR.

In principle, it is possible for Fed to respond immediately to this pessimism by seeing r^* is now r_{LR}. The MP shift lowers r to r_{LR} + shifts AD-π to original position leaving $Y = Y_{FE}$ + $\pi = \pi_0$. See slides for why this ~~pol~~ policy change is not easily done.