

# Lecture 8: The Goods Market and the Exchange Rate

- Devaluations (static and dynamic responses)
- Exchange rate determination (capital markets)

# The Goods Market

$$Z = C + I + G + X - eQ$$

$$C(Y-T) + I(Y,I) + G$$

$$Q = Q(Y,e)$$

+ -

$$X = X(Y^*,e)$$

+ +

# Figures

- Figs 19.1 and 19-2
- Increase in domestic and foreign demand
- games countries play
- depreciation

# The J-Curve

- $eQ(Y,e)$  : increase or decrease with  $e$ ?
- In the very short run: it may increase!
- And if strong enough:  $X(Y^*,e) - eQ(Y,e)$  may do the same.
- Dynamics of  $NX$  in response to a depreciation; fig 19-6

# The Exchange Rate

The Goods Market

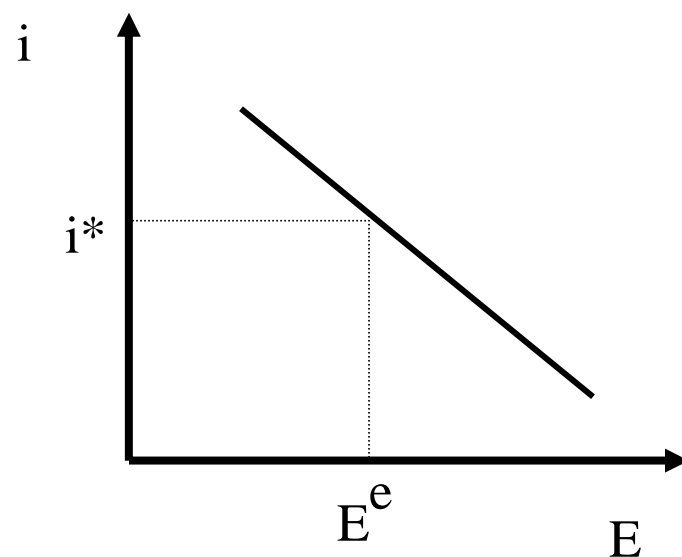
$$Y = C(Y-T) + I(Y,i) + G + NX(Y,Y^*, \underbrace{E P^*/P}_{\text{constant}})$$

Financial Markets

$$M/P = YL(i)$$

$$i(t) = i^*(t) + \frac{E^e(t+1) - E(t)}{E(t)}$$

# Cont. The Exchange Rate



$$i = i^* + \frac{E^e - E}{E}$$

given  $E^e$  and  $i^*$