Lecture 17: Real Interest Rates / Open economy AD-AS framework

• Nominal and real interest rates
• AD-AS in an open economy
Real and Nominal Interest Rates

IS: \[ Y = C(Y-T) + I(Y,r) + G \]

LM: \[ \frac{M}{P} = YL(i) \]

\[ r = i - \pi^e \]

The Long Run: \[ \pi^e = \pi = g_m - g_y \]

Changes are relatively small; a “constant.”

Fisher hypothesis / Figures 14-2 / 14-6 /14-7
AD-AS in Open Economy

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

infl. Approx = 0 / disregard dynamics

\[ Y = C(Y-T) + I(Y,i^*) + G + NX(Y,Y^*, \frac{E P^*}{P}) \]

\[ Y = Y(\frac{E P^*, G, T}{P}) \]

\[ P(t) = P(t-1) (1+\mu) \frac{F(1-Y(t), z)}{L} \]
Devaluation dynamics / Adjustment to an Overvaluation / Costs (expectations)

Figures 21-1 / 21-2 / 21-3