Lecture 8: The Goods Market and the Exchange Rate

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

\[ Z = C + I + G + X - e Q \]

\[ C(Y-T) + I(Y,I) + G \]

\[ Q = Q(Y,e) \]

\[ + - \]

\[ X = X(Y^*,e) \]

\[ + + \]
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

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

constant

Financial Markets

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

\[ i(t) = i^*(t) + \frac{E(t+1) - E(t)}{E(t)} \]
Cont. The Exchange Rate

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

given \( E^e \) and \( i^* \)