Lecture 20: Real and Nominal Interest Rates /Devaluations in an AD-AS framework

- Signs the U.S. economy is close to a recovery, such as a rebound in consumer confidence and retail sales, have sparked a rout in Treasuries the past two weeks. Investors have bet that indications of an economic pick-up will prompt the Federal Reserve to halt the interest-rate reductions that fueled this year's gains.
- Dollar May Rise vs Euro on View U.S. Economy May Soon Recover

- Real and nominal interest rates
- AD-AS in an open economy

Real and Nominal Interest Rates

IS: $Y = C(Y-T) + I(Y,r) + G$

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

$$\mathbf{r = i - \pi^e}$$

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

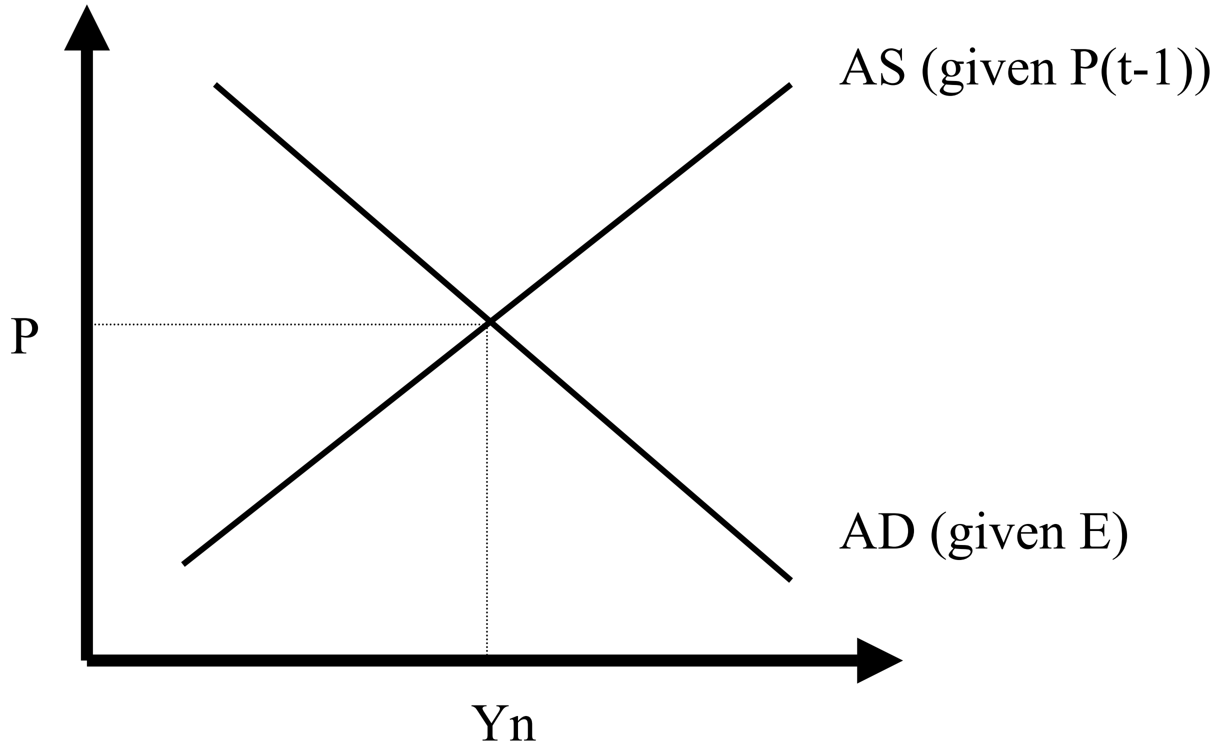
$$i = i^* + \frac{E^e - E}{E}$$

infl. Approx = 0 / disregard dynamics

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

$$Y = Y\Big(\overset{+}{\frac{E\,P^*}{P}}, \overset{+}{G}, \overset{-}{T}\Big)$$

$$P(t) = P(t-1)\,(1+\mu)\,F\left(1-\frac{Y(t)}{L}, z\right)$$



Devaluation dynamics / Adjustment to an Overvaluation / Costs (expectations)

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