Lecture 23: Devaluations in an AD-AS framework

- Current events (FT 11/29/99)
- Review
  - Real and nominal interest rates

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."

Dynamics: Figure 19-1 / Evidence: Figure 19-2 / Expectations

AD-AS in Open Economy

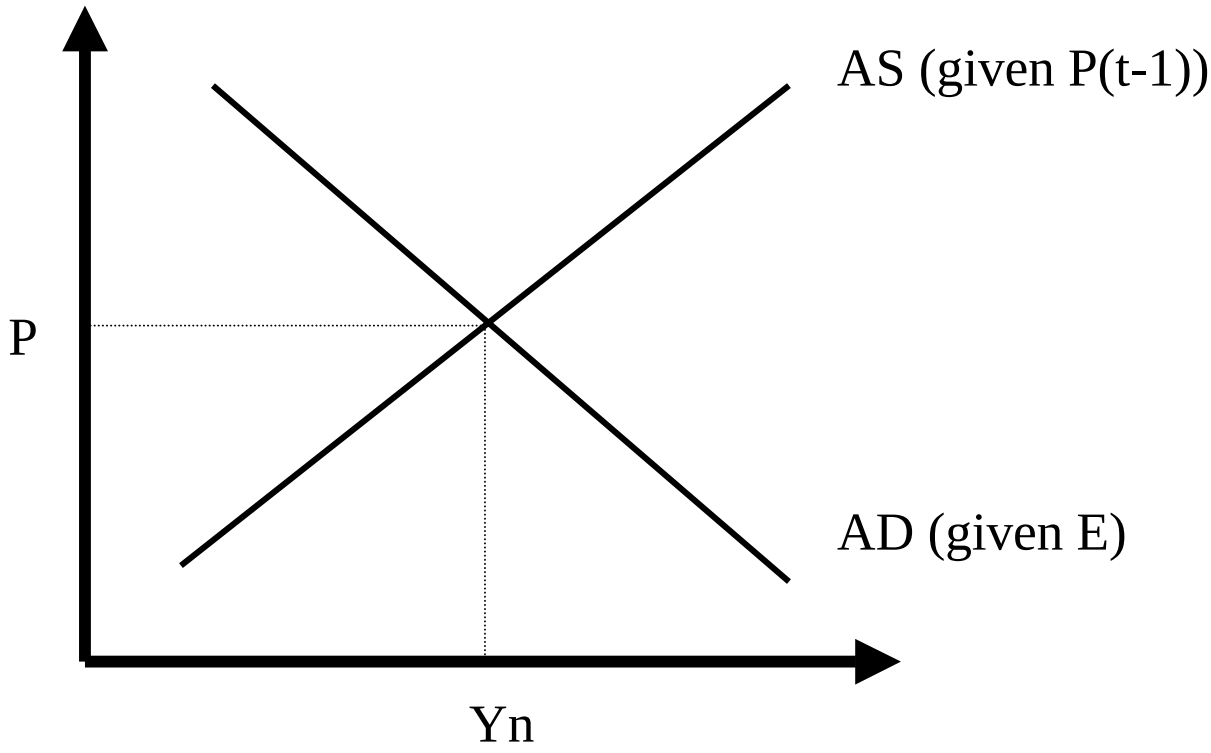
$$i = i^* + \frac{E^e - E}{E}$$

infl. Approx = 0 / disregard dynamics

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

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

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



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

Figures 19-4 and 19-5