Andreas Krause



Foreign exchange markets

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- The price of a currency, relative to another currency, is the exchange rate.
- The exchange rate is determined such that outcomes in both countries are
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Triangular arbitrage

- The exchange rate between different: currency pairs is kept consistent with approximate approximate
- Investors might directly exchange currencies A for currency B.
- Alternatively they can first exchange currency A for currency C, and then currency C for currency B
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Equal outcomes across countries

- Parities ensure that purchasing goods abroad and making investments are yielding the same outcome
- D They assume that prices and interest rates are given and only the exchange rate adjusts to avoid discrepancies
 - ? How would transaction costs affect parities?
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Money supply and sticky prices

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- > If the economy is in full employment, this would not allow markets to clear it
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- To clear markets, exchange rates overshoot the equilibrium price and re-adjust slowly with the wider economy afterwards
- The exchange rate is used to clear markets as it adjusts quickly, but this leads to volatile exchange rates
- 3 Will exchange rates partially reverse previous changes necessarily be a sign of overshooting?
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- Exchange rates should be set such that goods have identical prices across countries and investments yield the same returns
- As prices are slow to adjust to any shocks, the exchange rate will adjust quickly to clear markets at all times
- We can best interpret parities as the long-run equilibrium that exchange rates should achieve
- Due to exogenous shocks, for example from monetary policy, we might see.
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