

The effect of monetary shocks

# Outline

- Monetary policy decisions
- Money market
- Goods market
- Equilibrium
- Summary

## ■ Monetary policy decisions

■ Money market

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■ Equilibrium

■ Summary

# Changes in money supply

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- The **evolution** of the exchange rate and price level is given by

$$\Delta e = \frac{\ln P - \ln \bar{P}}{\varepsilon_r}$$

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- ▶ An increase in the money supply will **increase the price** level due to the output being given

# Impact of monetary policy

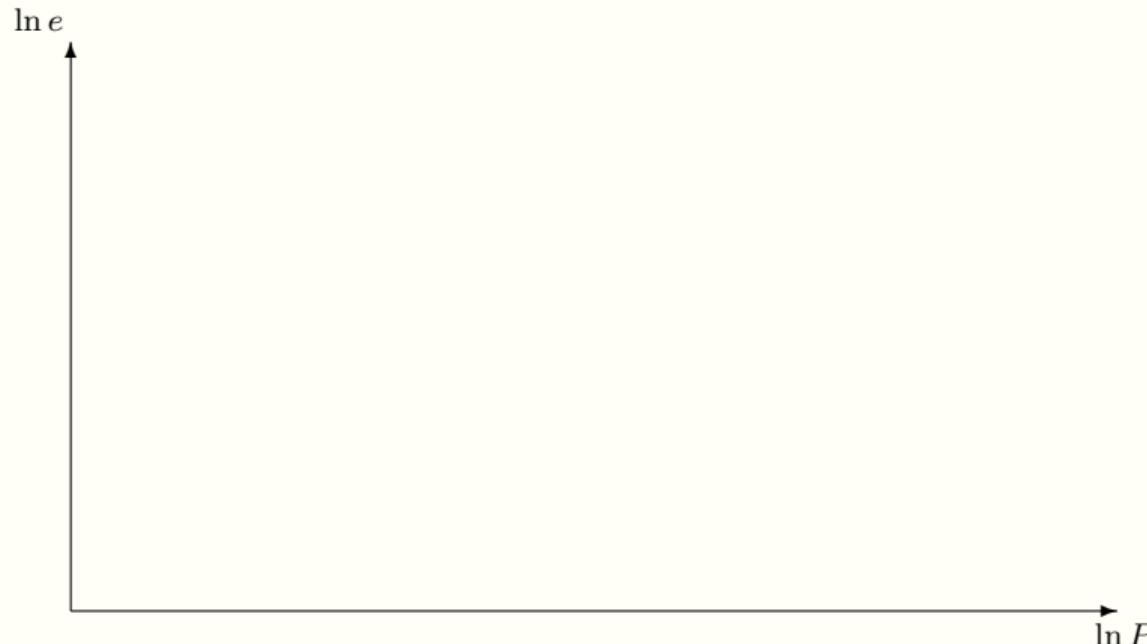
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- ▶ From the relationship of exchange rates and price levels in equilibrium, this implies a **higher exchange** rate

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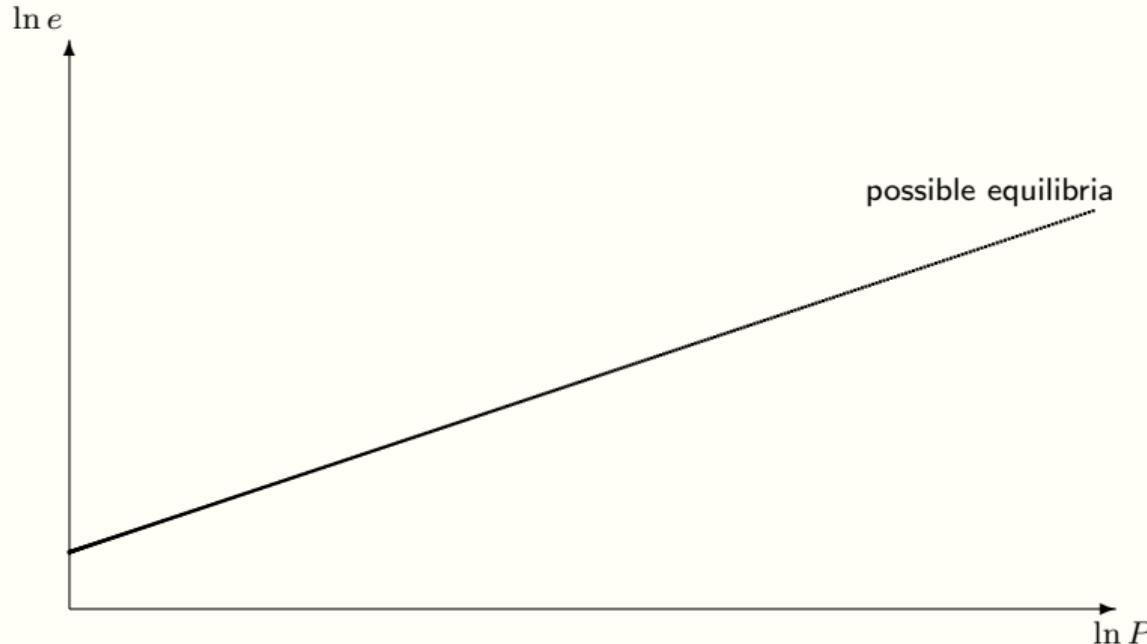
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# Reaction to an increase in money supply

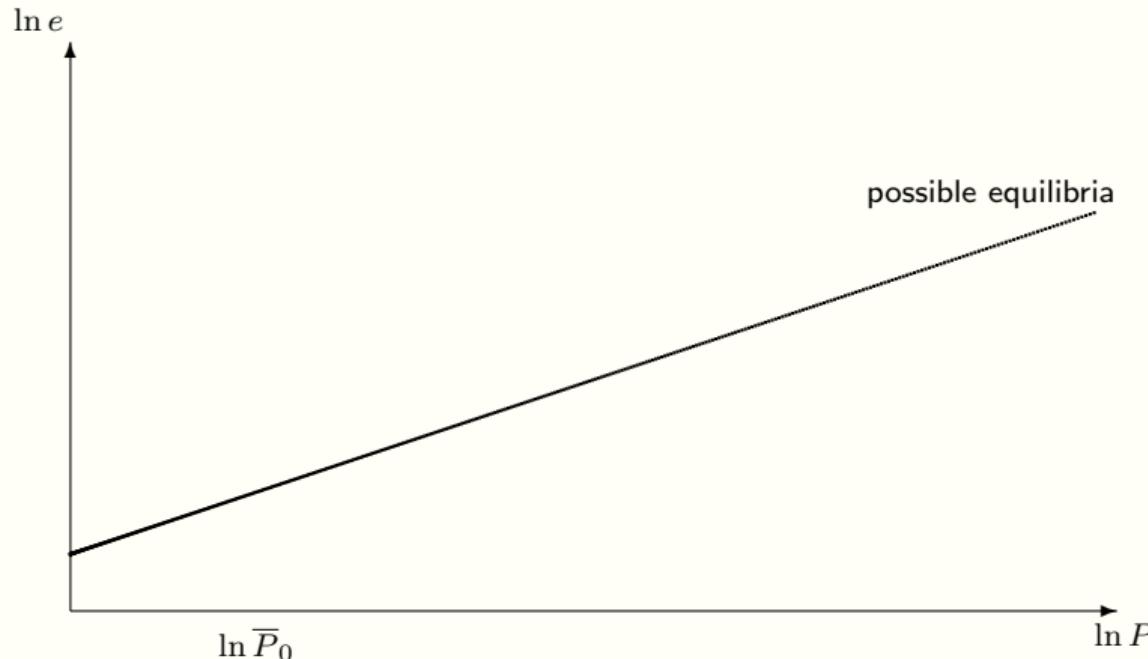
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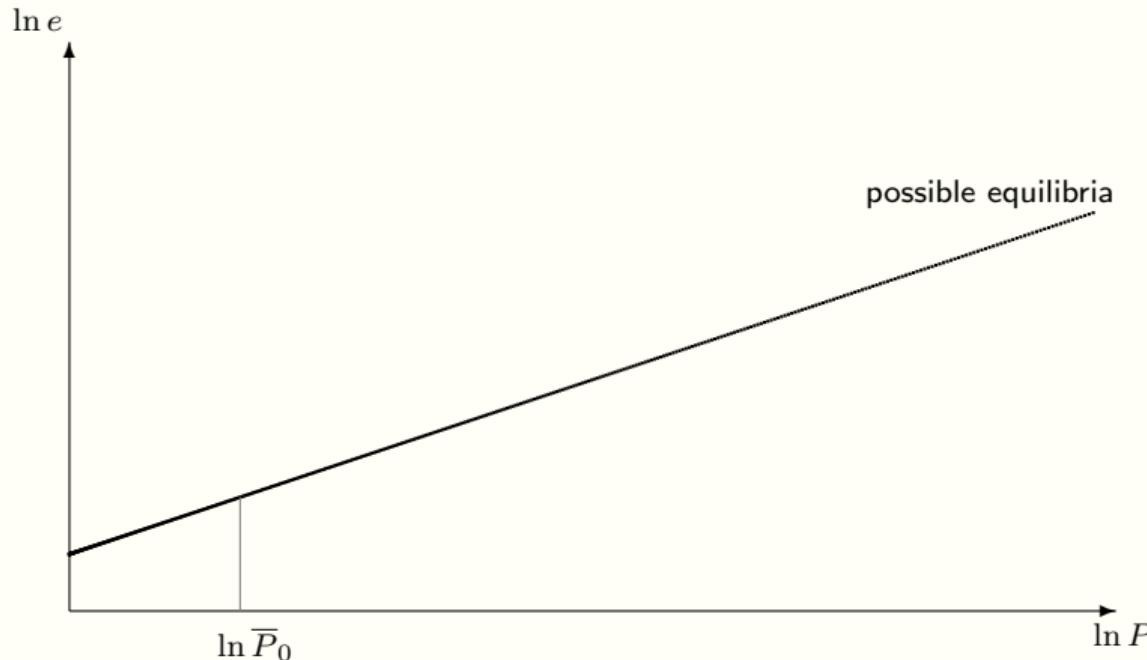
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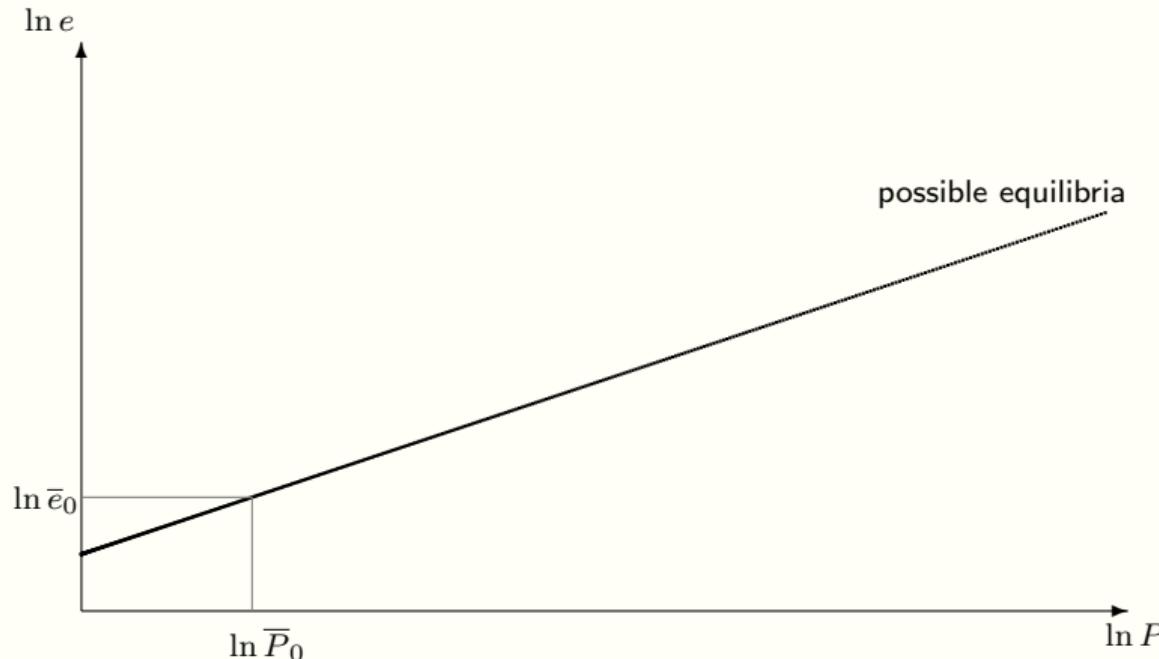
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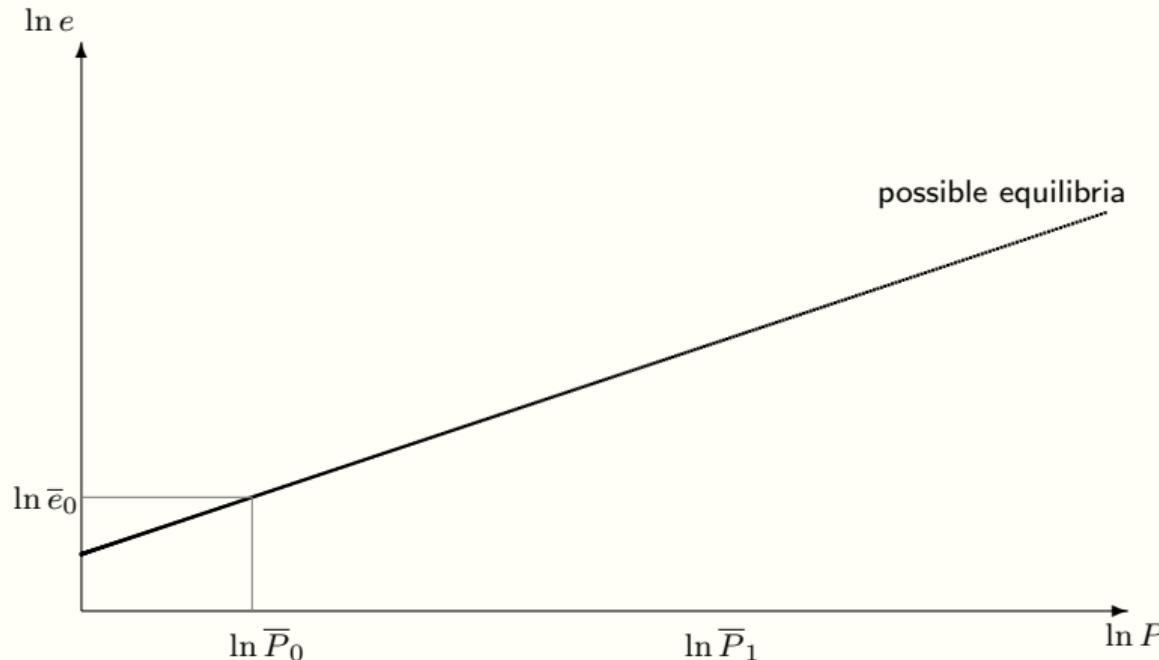
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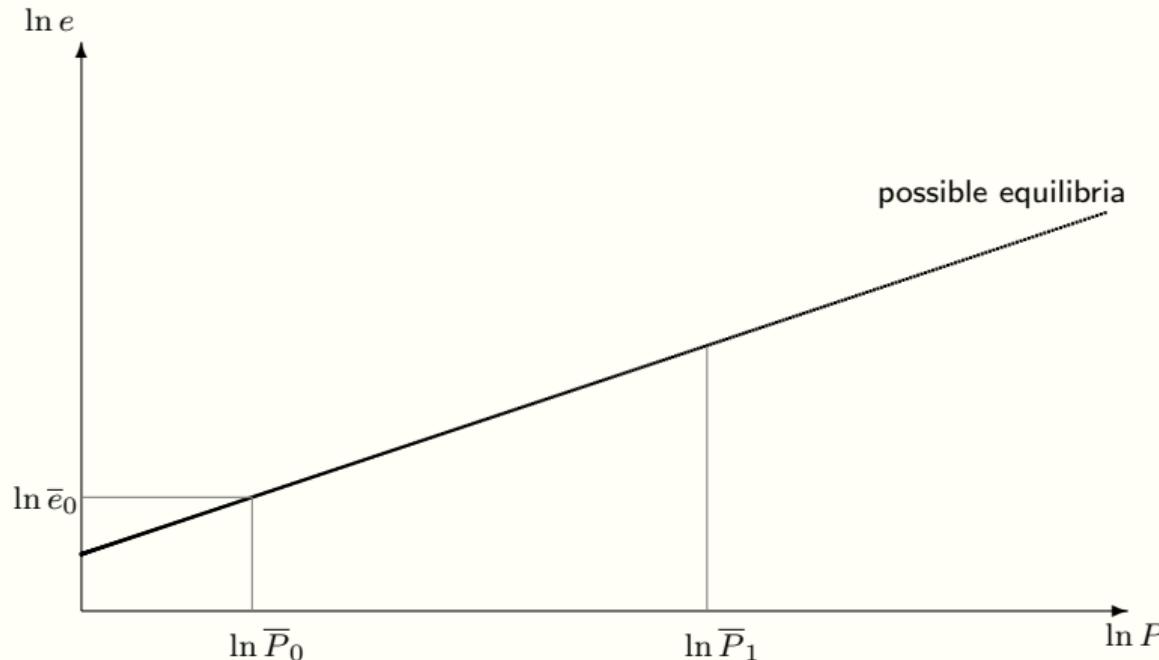
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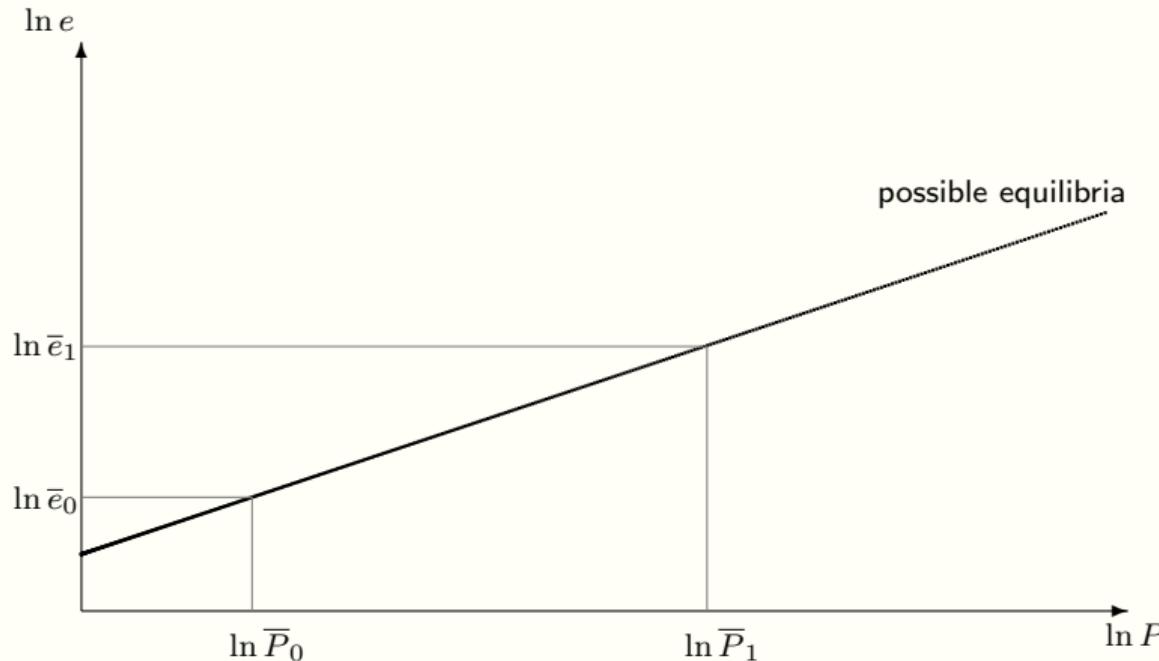
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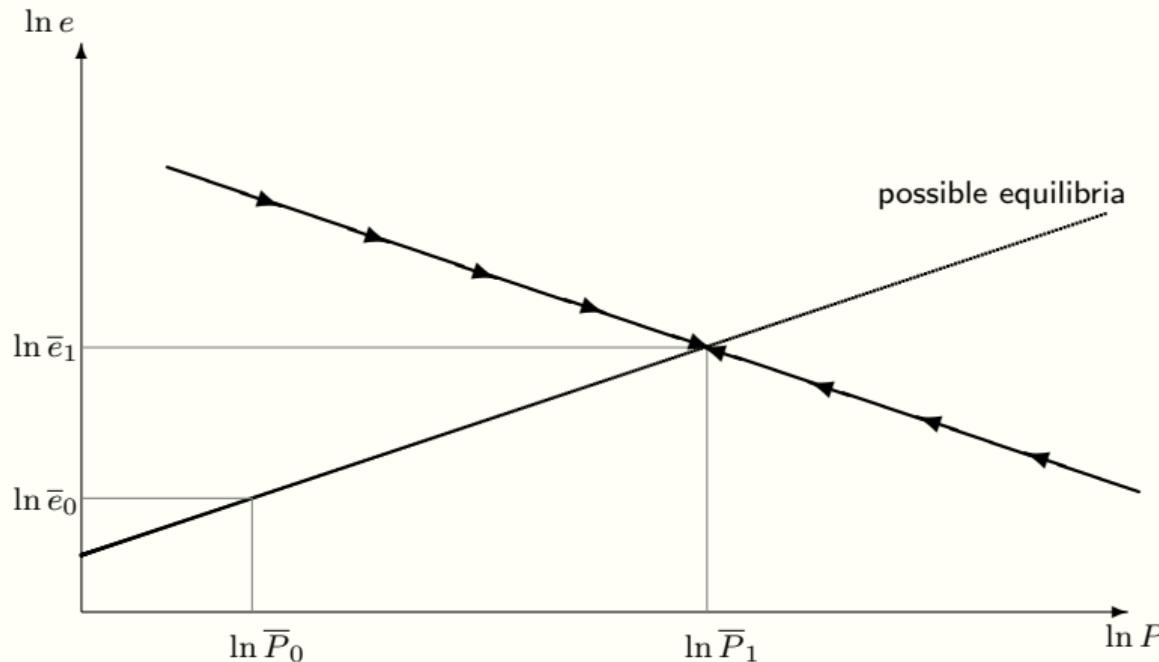
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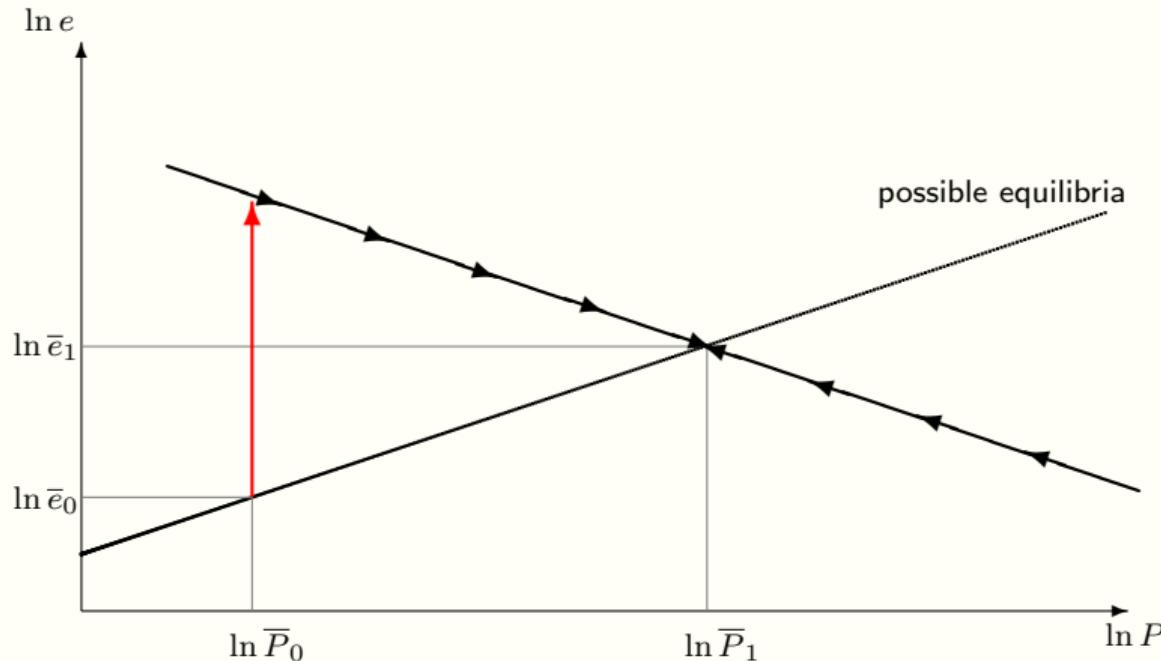
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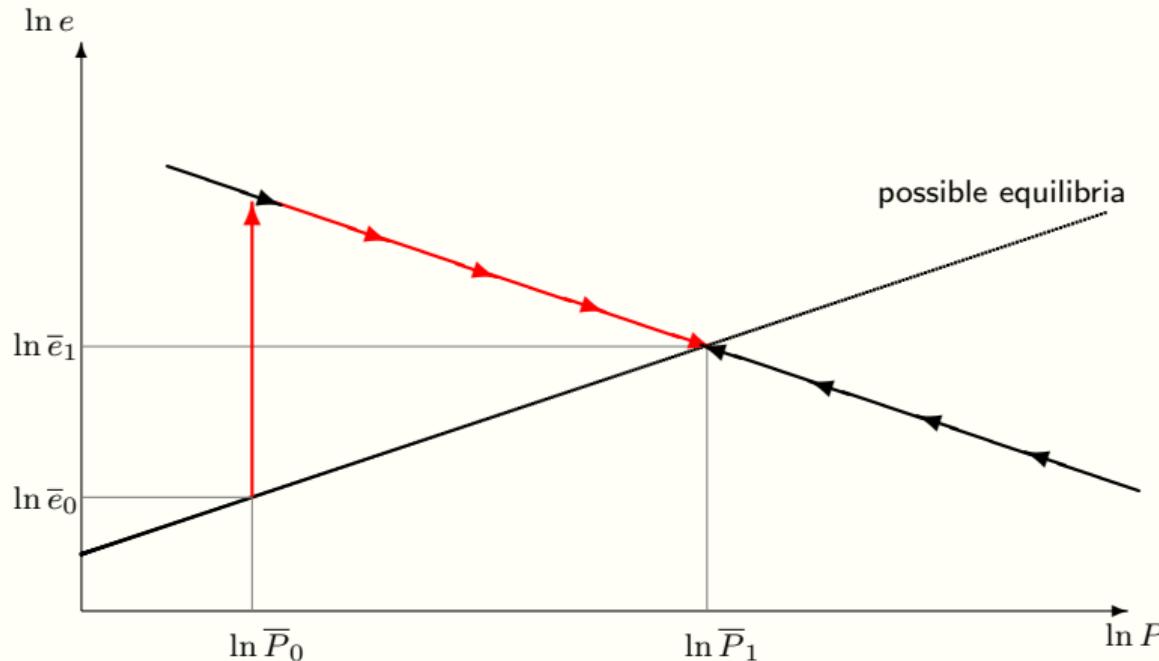
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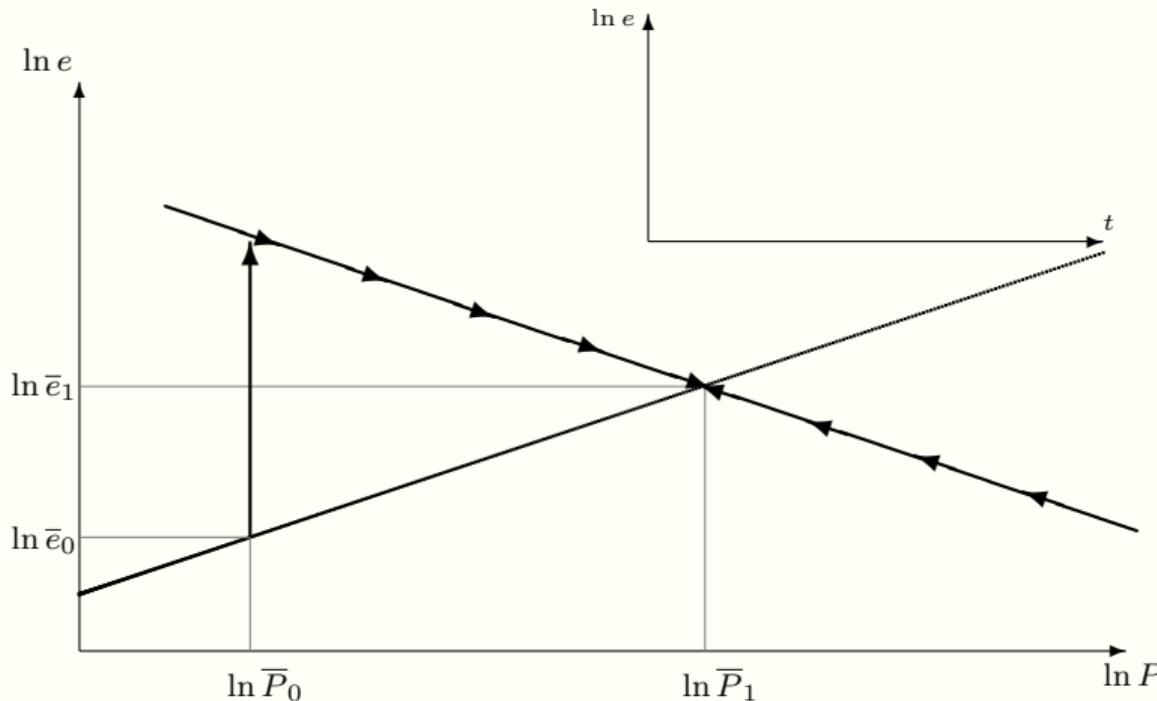
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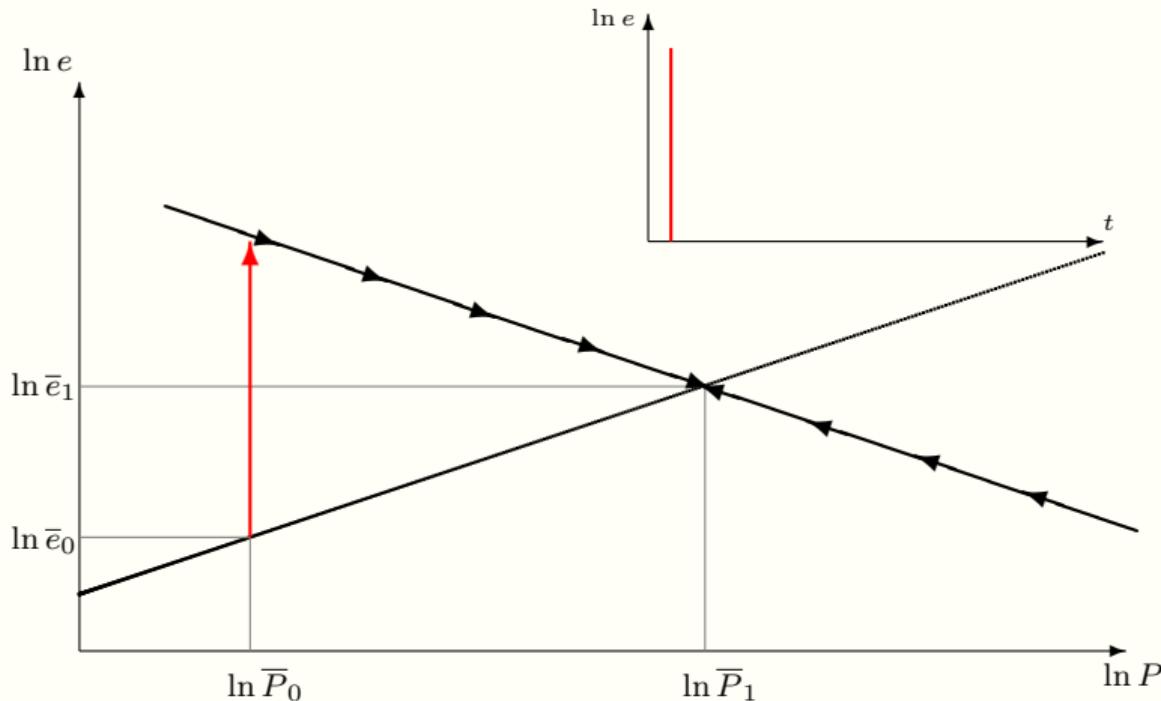
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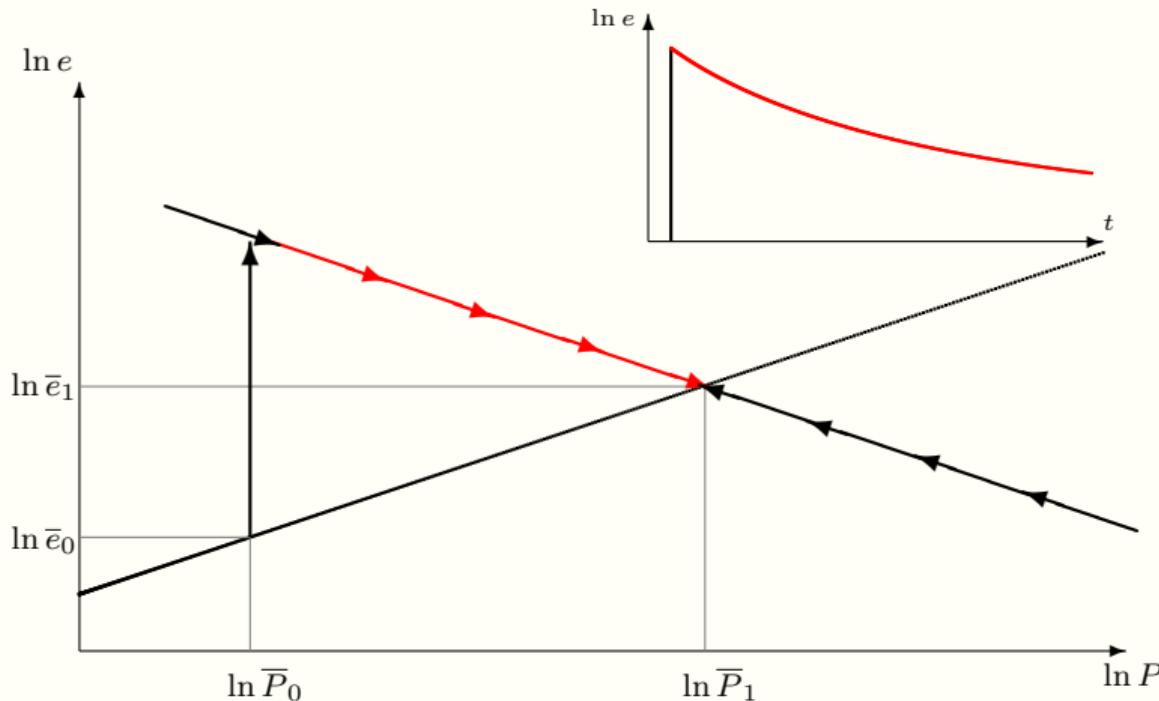
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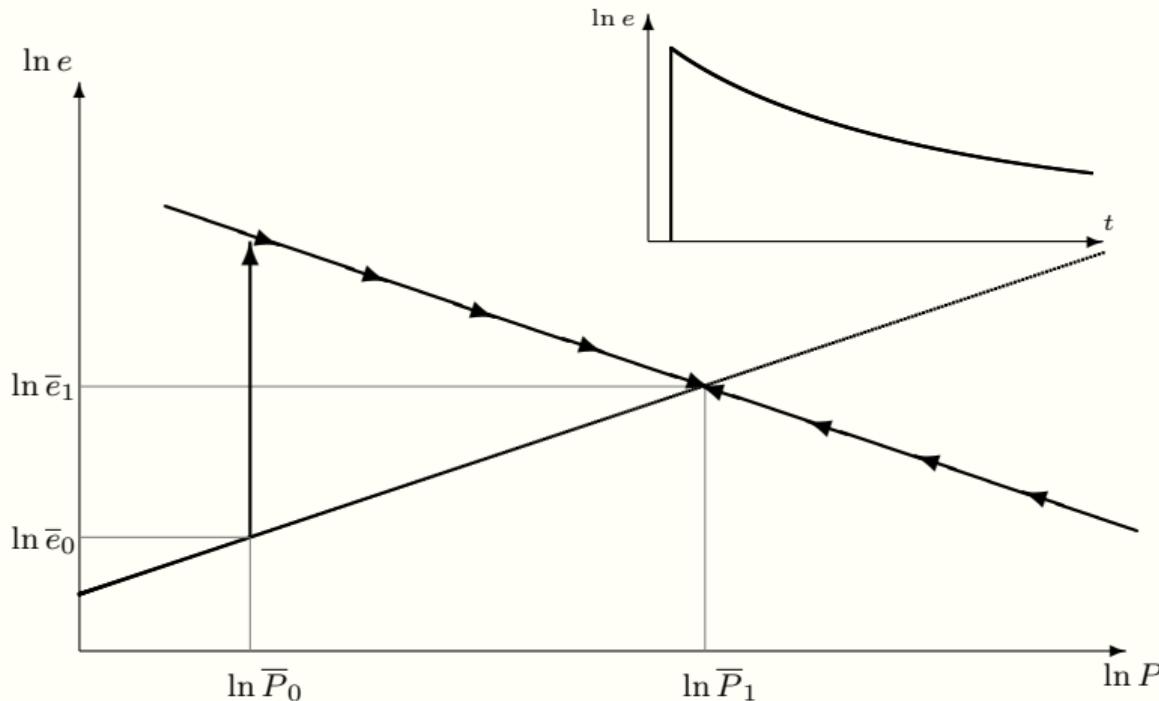
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# Overshooting exchange rates

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- Monetary policy decisions
- Money market
- Goods market
- Equilibrium
- Summary

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