



The effect of monetary shocks

Outline

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

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Changes in money supply

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Impact of monetary policy

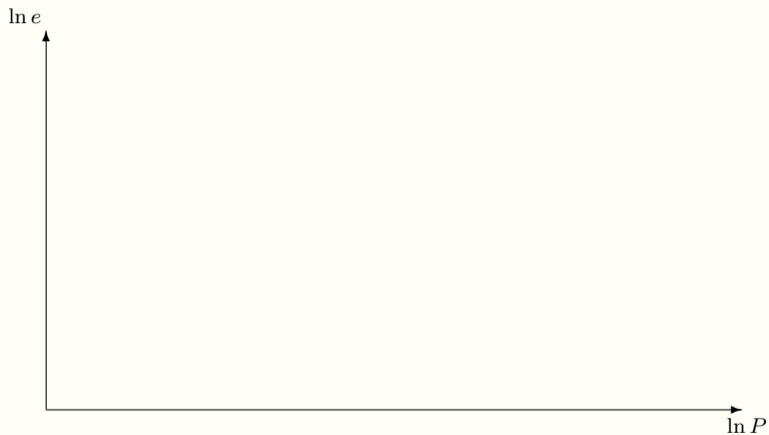
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- ▶ From the relationship of exchange rates and price levels in equilibrium, this implies a **higher exchange** rate

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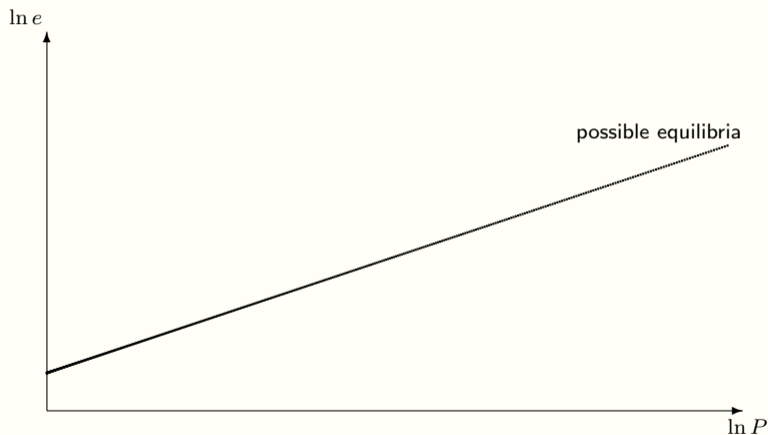
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Reaction to an increase in money supply

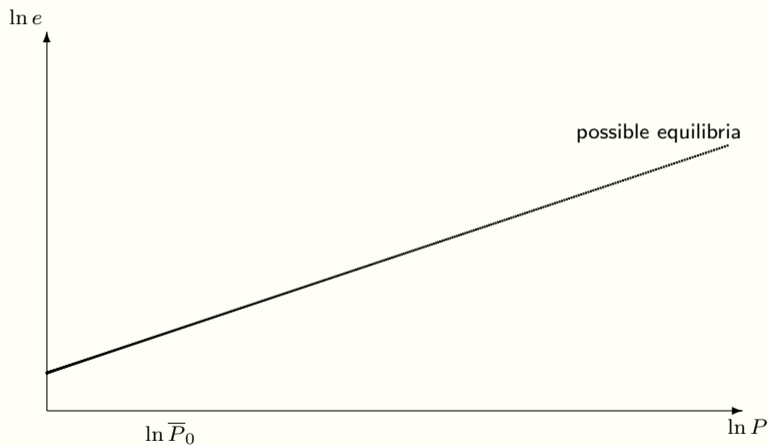
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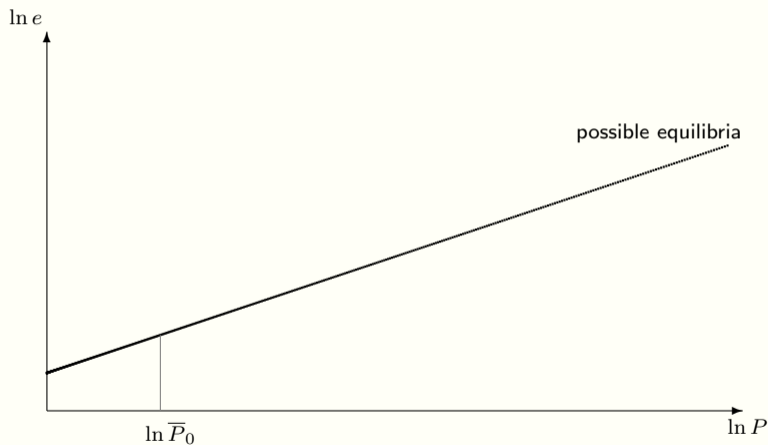
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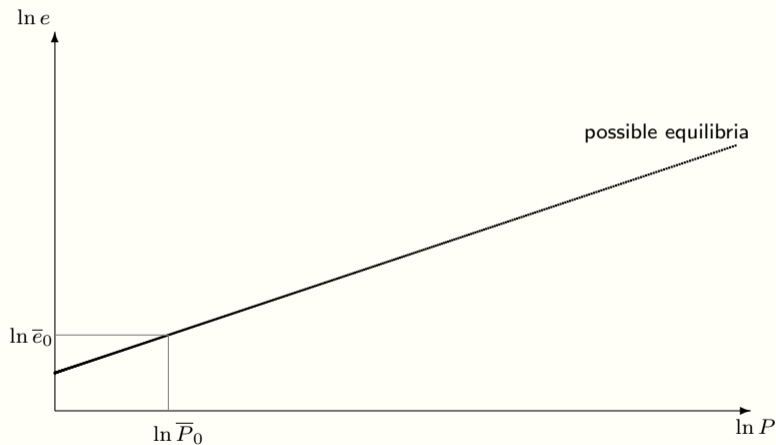
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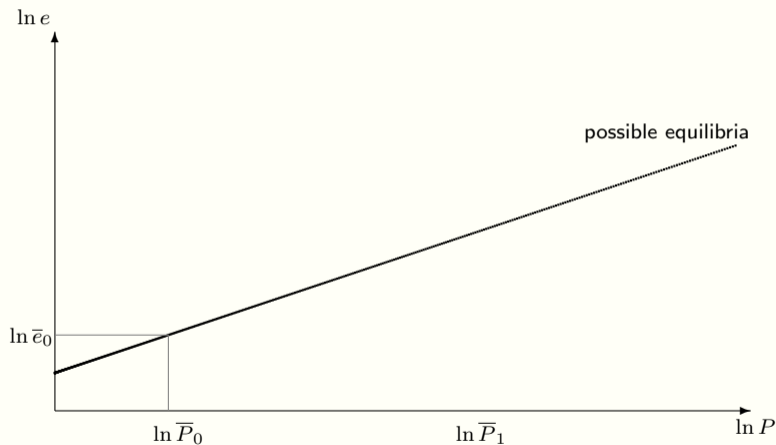
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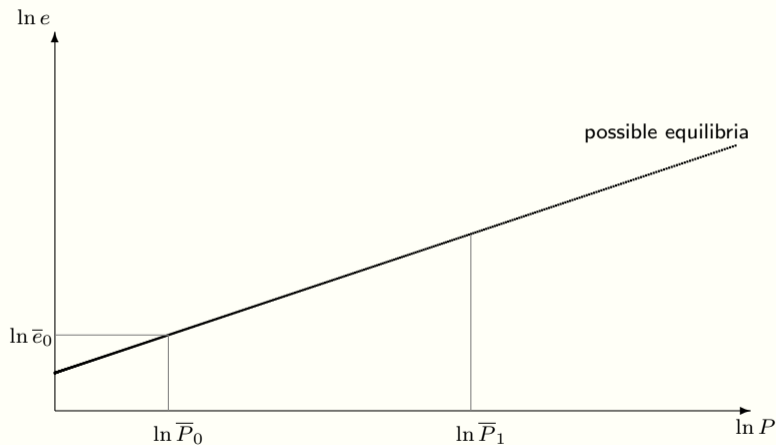
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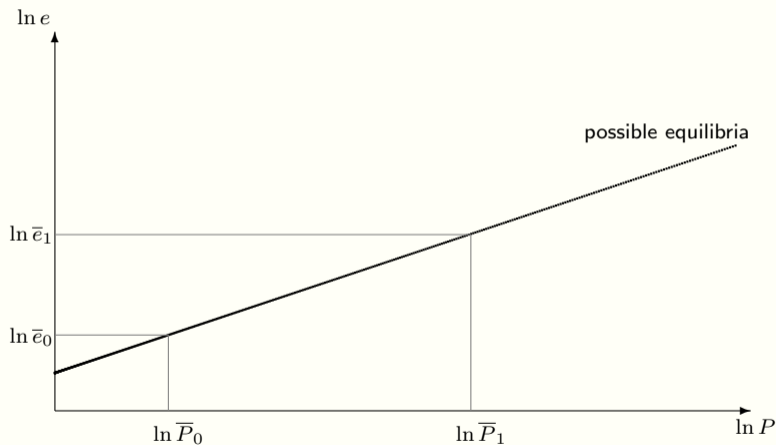
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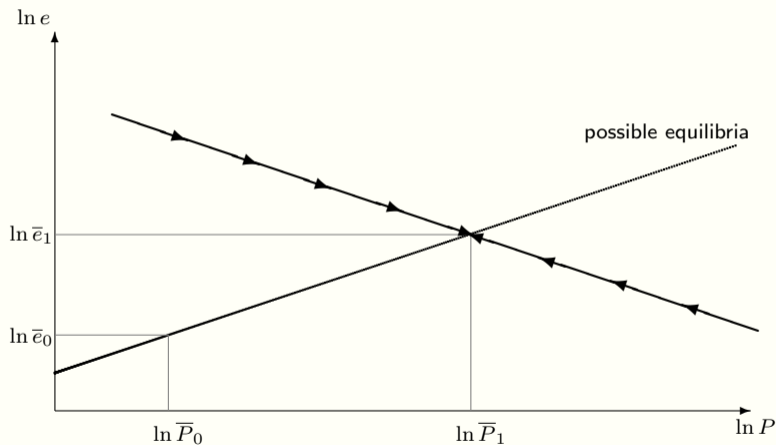
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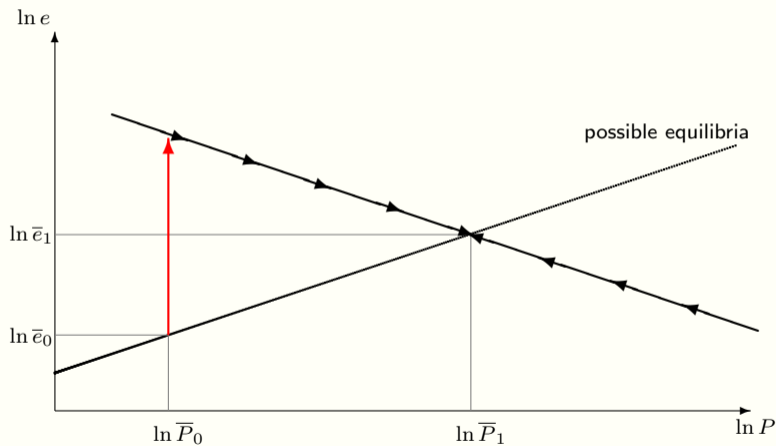
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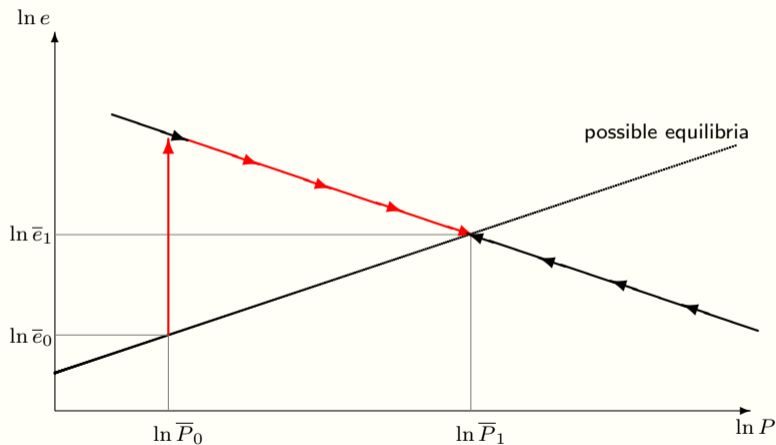
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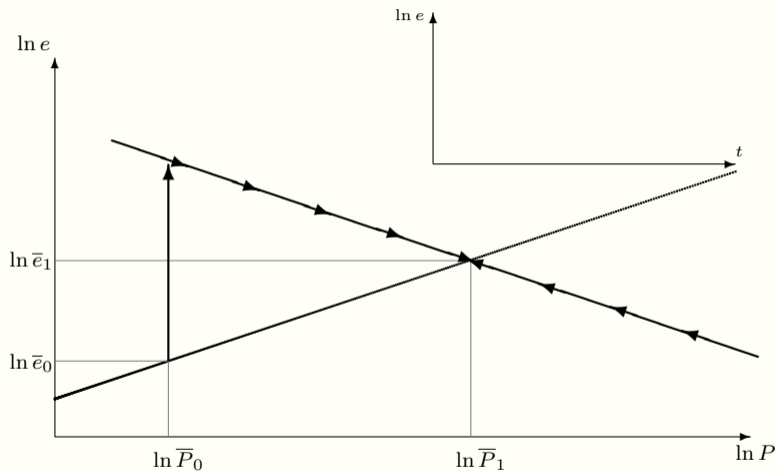
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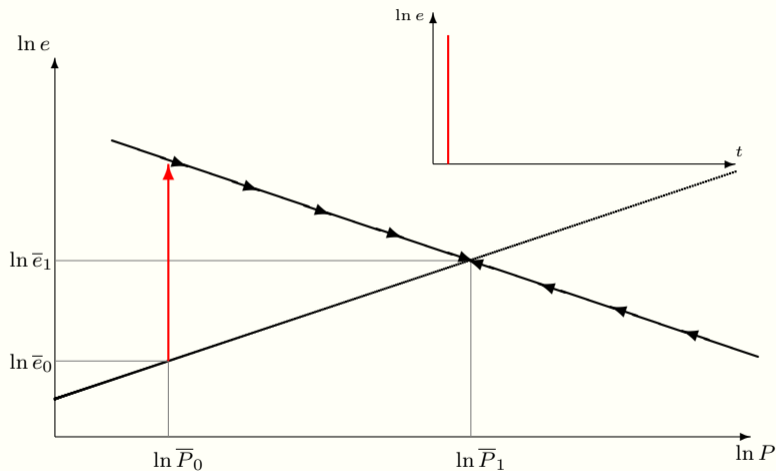
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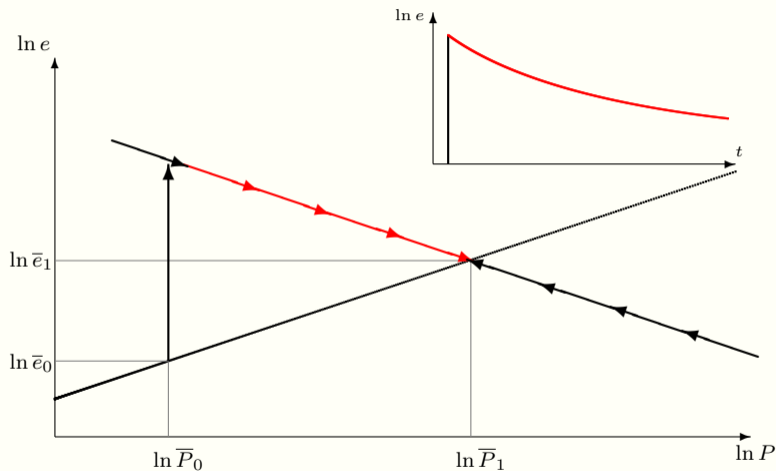
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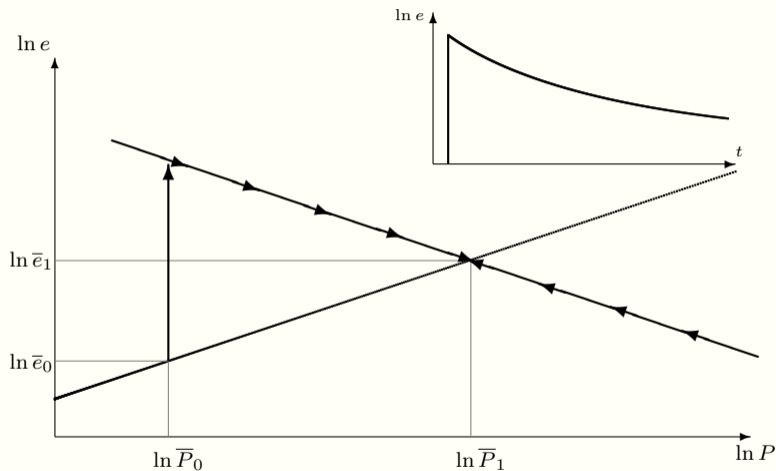
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Overshooting exchange rates

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- ▶ As price levels adjust **slowly**, the exchange rate then adjusts **slowly** towards its equilibrium

Overshooting exchange rates

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- ▶ As price levels adjust slowly, the exchange rate then adjusts slowly towards its equilibrium
- ▶ The exchange rate initially **overshoots** the equilibrium exchange rate and then slowly falls back

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

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Andreas Krause
Department of Economics
University of Bath
Claverton Down
Bath BA2 7AY
United Kingdom

E-mail: mnsak@bath.ac.uk