Lecture 17: Real Interest Rates / Open economy AD-AS framework

- Nominal and real interest rates
- AD-AS in an open economy

Real and Nominal Interest Rates

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

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

$$r = i - \pi^e$$

The Long Run: $\quad \pi^e = \pi = g_m - g_y$

Changes are relatively small; a "constant."
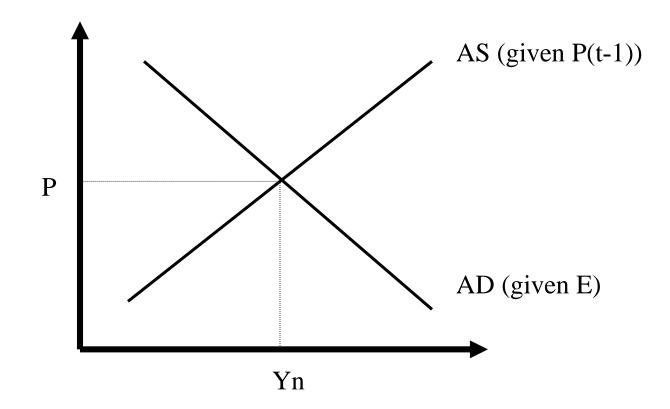
Fisher hypothesis / Figures 14-2 / 14-6 /14-7

AD-AS in Open Economy

$$i = i* + \frac{E^e - E}{E} \qquad \text{infl. Approx} = 0 \text{ / disregard dynamics}$$

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

$$\begin{array}{ccc} + & + & - \end{array}$$

$$Y = Y(\frac{E\,P*}{P}, G, T)$$

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

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

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