

Open Economy Macroeconomics

Asbjorn Rodseth UNIVERSITY OF OSLO

CAMBRIDGE | W UNIVERSITY PRESS

Contents

	List of	figures p	age viii
	List of tables		X
	Preface		xi
	List of standard symbols		xii
	Introduction		1
1.1	The field		1
1.2	The book		2
1.3	The approach		5
1.4	Prerequisites		6
Part 1	Financial markets		
1	The foreign exchange market		9
1.1	Some basic concepts		9
1.2	The balance sheet		12
1.3	The demand for currencies		16
1.4	A simple portfolio model		18
1.5	Capital mobility, interest rates ar	d expectations	24
1.6	The current account and the gov	ernment surplus	32
1.7	The forward market and covered	interest rate parity	35
2	Portfolio choice, risk premia an	d capital mobility	40
2.1	Mean-variance analysis and the	demand for foreign currency	40
2.2	The equilibrium risk premium		47
2.3	Further discussion of the mean-v	variance model and extensions	50
2.4	Expected utility maximization: ar	ı example	56
2.5	The degree of capital mobility be	tween currencies	59
3	Money		63
3.1	A portfolio model with money		63
3.2	Money demand and currency su	ostitution	78
3.3	Banks		84
3.4	Currency boards, target zones an	d the role of foreign exchange reserve	es 90

4	The monetary theory of the exchange rate	97
4.1	Exchange rate equilibrium with rational expectations	98
4.2	Temporary and permanent shocks, anticipations and news	102
4.3	The nominal anchor	109
Part 2	The open economy	
5	The extremely open economy	113
5.1	Real interest rates	115
5.2	Income accounting	115
5.3	The specie-flow mechanism	117
5.4	Imperfect capital mobility: fixed exchange rate	125
5.5	Imperfect capital mobility: floating exchange rate	128
5.6	Government deficits	134
5.7	Wage rigidity	138
5.8	Real capital and investment	145
5.9	Unions and wage bargaining	148
5.10	Wealth dynamics in a growing economy	153
5.11	Some further questions	160
6	Home and foreign goods	166
6.1	The trade balance and the Marshall-Lerner condition	166
6.2	The Mundell-Fleming-Tobin model	169
6.3	Fixed exchange rate	171
6.4	Floating exchange rate	180
6.5	Some observations on real interest rates, expected inflation and the	
	choice of deflator	185
6.6	From short- to long-run equilibrium: the price-specie-flow mechanism	190
6.7	Floating rate dynamics and overshooting	204
6.8	A more general dynamic model	211
7 T	raded and non- traded goods	217
7.1	The basic static model	218
7.2	Alternatives and extensions	229
7.3	Wage dynamics	240
7.4	Capital stock dynamics	245
7.5	Real capital in both industries	250
7.6	The Scandinavian model of inflation	254
8	Alternative market structures, purchasing power parity and	
	monopolistic competition	260
8.1	Purchasing power parity, the law of one price and nominal rigidities	261
8.2	Monopolistic price-setting	266

vii

8.3	Pricing to market	269
8.4	Customer markets, 'beach-head' effects and multinational firms	273
8.5	Wage bargaining: the wedge	277
Part 3	Policy issues	
9	International interactions	287
9.1	The international monetary system	287
9.2	The international transmission of shocks	293
9.3	Policy coordination	312
9.4	Monetary union and optimal currency areas	316
	Appendix: deriving the properties of the aggregate demand functions	319
10	Exchange rate policy	323
10.1	Exchange rate versus price level targets and output stability	325
10.2	Credibility and speculative attacks	336
10.3	The benefits of having one's own currency	347
	Appendixes	
A	Differential equations in two variables	353
В	The homogeneous production function	359
Notes		361
Bibliography		
Index		381