

The Role of Private Financial Wealth in a Portfolio Model

**A Study of the Effects of Fiscal Deficits
on the Real Exchange Rate**

Angel Calderón-Madrid

*Professor of Macroeconomic Theory and International Economics
El Colegio de Mexico
Mexico City*



Contents

<i>Preface</i>	vii
<i>Introduction</i>	ix
1 Long-Run Effects of Fiscal Policy and Domestic Public Debt on the Real Levels of Exchange Rate and GDP	1
Introduction and Summary of Results	1
A Mundell–Fleming Model with a Supply Side	4
Specification of the Model	4
Description of the Model	5
Effectiveness of Fiscal Policy in Changing the Level of GDP: the Case of a Downward-flexible Real Wage	11
Reduced-form Solution	12
Long-run Multipliers of Public Expenditure on GDP	15
Foreign Trade Multipliers	18
Effectiveness of fiscal policy to change the level of GDP: The case of real wage rigidity	20
Equilibrium Solution	21
Effects on the Level of Exchange Rate	24
Effects on the Level of GDP	27
Concluding Comments	30
2 The Dynamics of Real Exchange Rate and Financial Assets of Contractionary Fiscal Policies cum Private Dissavings	31
Introduction and Summary of Results	31
A Dynamic Model of the Real Exchange Rate	35
Specification of the Model	35
Steady-state Representation	41
Analysis of the Steady-State Characteristics of the Model	42

Dynamic Analysis Resulting from Private Dissavings cum Contractionary Fiscal Policies	51
The Mundell–Fleming Results and the Monotonic Convergence Path to the long-run Equilibrium	51
Impact Exchange Rate Adjustment	53
A Non-Monotonic Convergence Path	56
Analysis of the Dynamic Characteristics of the System Matrix	61
3 Stock-Flow Adjustment and the Speed of Convergence of the Economy towards its Long-Run Equilibrium	67
Introduction and Summary of Results	67
Specification of the Model	70
Simplifying Assumptions and Policy Rules	70
Analysis of the Single-Period Structure of the Model	75
Analysis of the Dynamic Structure of the Model	83
Determinants of the Speed of Adjustment of the Economy Toward its Long-run Equilibrium	88
Medium-term Determination of the Level of GDP and the Speed of Adjustment of GDP Toward its Long-run Equilibrium	89
Distributed Lag Models and the Dynamic Determination of Privately-held Financial Assets	94
Determinants of the Speed of Convergence of Privately held Financial Assets to its Long-run Equilibrium Level	97
Determinants of the Speed of Convergence of the Level of GDP to its Long-run Equilibrium	100
Medium-term Effects of Stocks on the Level of GDP and the Overshooting of the Long-run Equilibrium	107
Stability Conditions	112
Concluding Comments	115
<i>Notes and References</i>	117
<i>Bibliography</i>	121
<i>Index</i>	125