

## Contents

For	eword ix	
Pre	face xi	
Ack	nowledgments xiii	
1.	Introduction	1
1.1	Mathematical Modeling	2
1.2	Book Structure	4
PΑ	RT I Definitions	
2.	How to Measure International Transactions	g
2.1	Balance of Payments	10
2.2	National Accounts	15
2.3	Balance of Payments Equilibrium	18
2.4	Open Economy Models	26
	Mathematical Appendix	27
2.5	Exercises	28
3.	The Foreign Exchange Market	31
3.1	The Nominal Exchange Rate	32
3.2	The Goods and Services Market: The Real Exchange Rate	36
3.3	The Assets Market: Interest Rate Parity Conditions	45
	Mathematical Appendix	54
3.4	Exercises	55

## PART II Current Account and Real **Exchange Rate**

4.	What Is the Optimum Current-Account Level?	63
4.1	Basic Hypotheses	64
4.2	Consumption Smoothing	65
4.3	Comparing with a Closed Economy	73
4.4	How Economic Shocks Affect the Current Account	76
4.5	Adding Government	79
4.6	The Model with Production and Investment	81
4.7	The Model and the World	87
4.8	Exercises	93
5.	The Equilibrium Real Exchange Rate	103
5.1	The Real Exchange Rate and the Price of Nontradable Goods	104
5.2	Production, Consumption, and Equilibrium	106
5.3	How Does the Real Exchange Rate Respond to Shocks?	117
	Mathematical Appendix	130
5.4	Exercises	139
PA	RT III Determination of the Nominal Exchange Rate	
6.	Money and Exchange Rate in the Long Run	147
6.1	Money, Assets, and Goods Markets	148
6.2	Exchange Rate Fundamentals	150
6.3	Applications, Extensions, and Limits of the Model	160
	Mathematical Appendix	161
6.4	Exercises	163

7.	Macroeconomic Policies and Exchange Rate		
	in the Short Run	169	
7.1	Rigid Prices: The Mundell—Fleming Model	170	
7.2	Sticky Prices: The Mundell—Fleming—Dornbusch Model	182	
7.3	Monetary Models with Price Rigidity: Their Uses and Limitations	189	
7.4	Exercises	191	
8.	Portfolio Diversification and Capital Flows	195	
8.1	Assets from Different Countries: Imperfect Substitutes	197	
8.2	Gross Capital Flows and Current Account	198	
8.3	Net International Investment Position	202	
8.4	Impact of Shocks on Exchange Rate and Current Account	211	
	Mathematical Appendix	223	
8.5	Exercises	223	
PA	RT IV Crises and Exchange Rate Policy		
9.	Currency Crises	229	
9.1	The Speculative Attack as Asset Price Arbitrage	230	
9.2	Crises as Self-Fulfilling Prophecies	237	
9.3	The Role of Banks and Foreign Debt	245	
9.4	Contagion	256	
9.5	Exercises	257	
10.	Exchange Rate Regimes	265	
10.1	Classification of Exchange Rate Regimes	266	
10.2	What Exchange Rate Regime Should Be Chosen?	270	
	Mathematical Appendix	291	
10.3	Exercises	292	

## viii Contents

11.	Political Economy of Exchange Rate Policy	297
11.1	Distributive Impacts of the Real Exchange Rate	298
11.2	Exchange Rate as an Indicator of Competence	311
11.3	The Economic Policy of Fiscal Policy	314
	Mathematical Appendix	318
11.4	Exercises	325

## PART V

Annexes 333

References 337

Index 341