

APRIL 17, 2019

(1)

Things to keep in mind

$$M \uparrow \rightarrow r \downarrow \quad \left( \begin{array}{l} \text{via} \\ \text{open market operations} \\ \text{by the CB} \end{array} \right)$$

$$r \uparrow \rightarrow \begin{cases} \varepsilon \downarrow & \text{(flex. rate)} \\ R \uparrow & \text{(fixed } \varepsilon) \end{cases}$$

$$R \uparrow \rightarrow M \uparrow$$

$$\varepsilon \uparrow \rightarrow (Exp - Imp) \uparrow \quad \left( \begin{array}{l} \text{a stunning} \\ \text{Marshall} \\ \text{Lerner} \\ \text{condition} \\ \text{holds} \end{array} \right)$$

Note that to be rigorous we should ~~write~~ write:

$$Exp(P, \varepsilon) P - Imp(P, \varepsilon) P \cdot \varepsilon$$

Real/volumes

Real/volumes

Nominal value of imports  
in national currency

# Public debt financing

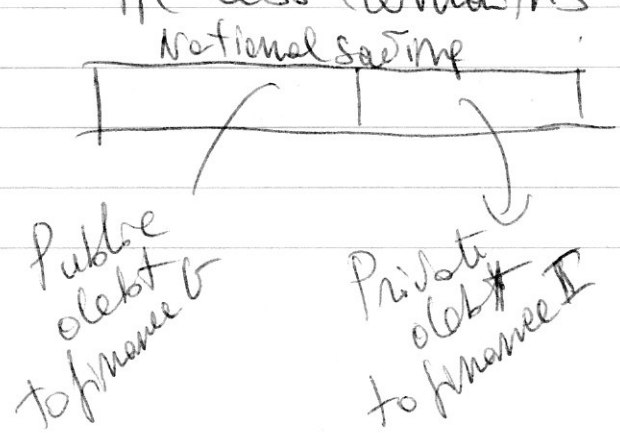
When  $(T - G) < 0$  the gov't budget is in deficit, which can be financed in two ways: money or debt! What are the differences?

## ① Money financing (fiat money)

This solution provides extra purchasing power to the Gov't but normally leads to higher inflation ~~the result~~ in the end the effect on growth may be zero. You would end up with higher  $G$ , but lower  $C$ ,  $I$  and  $Exp$ .

## ② Debt financing

In this case you are <sup>(relying)</sup> on the existing "pool" of national saving (no extra purchasing power). However, saving is used to finance investment and the more of it is used to pay for public spending, the less remains to finance private investment. This is called:



"Crowding out" effect -