

MUNDELL-FLEMING MODEL

Small open economy, fixed prices (Keynesian unemployment), domestic income = domestic product, imperfect substitutability of goods (PPP does not hold), perfect substitutability of bonds (but imperfect substitution).

THE MODEL (deviation from equilibrium) :

- (IS) $sY = -nR + G - zY + Y_f + \theta Q$ goods market equilibrium
 (LM) $M = \lambda Y - \beta R$ money market equilibrium
 (BP) $-zY + Y_f + \theta Q + \phi(R - R_f) = 0$ foreign currency market (BoP flow equilibrium)

Y = national income ; R = domestic interest rate ; Q = exchange rate (home currency price of '\$') ; M = money supply ; G = government expenditures ; Y_f = foreign income ; R_f = foreign interest rate

degree of international capital mobility : high if $\phi - z\beta/\lambda > 0$; low if $\phi - z\beta/\lambda < 0$.

SOLUTION : FLEXIBLE EXCHANGE RATE

SOLUTION : FIXED EXCHANGE RATE

$$Y^* = \frac{\beta(G + \phi R_f) + (n + \phi)M}{s\beta + \lambda(n + \phi)}$$

$$Y^* = \frac{\phi G + (\phi + n)(Y_f + \theta Q) - n\phi R_f}{nz + (s + z)\phi}$$

$$R^* = \frac{\lambda(G + \phi R_f) - sM}{s\beta + \lambda(n + \phi)}$$

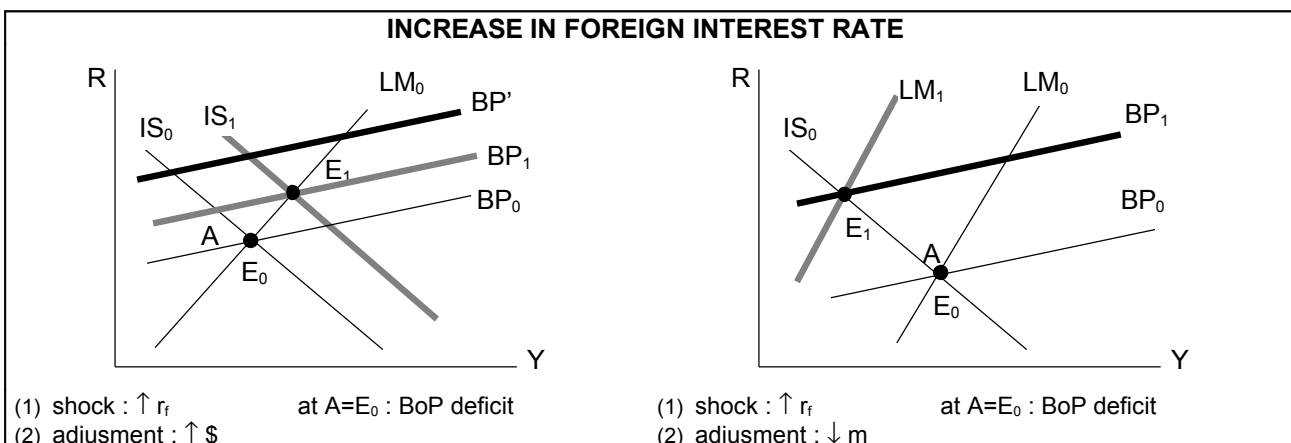
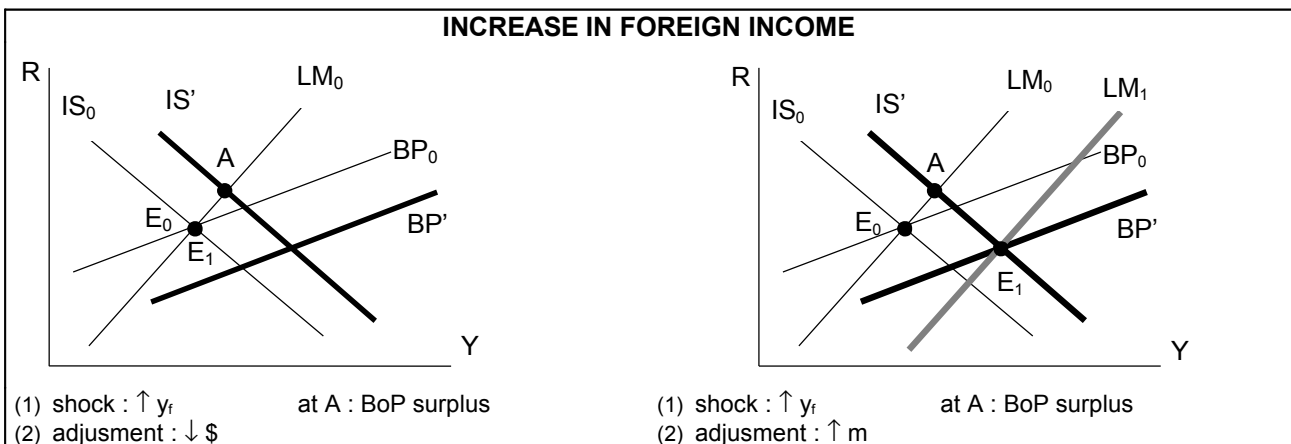
$$R^* = \frac{zG - s(Y_f + \theta Q) + (s + z)\phi R_f}{nz + (s + z)\phi}$$

$$Q^* = \frac{(z\beta - \lambda\phi)G + (n\lambda + (s + z)\beta)\phi R_f + (nz + (s + z)\phi)M - Y_f}{\theta(s\beta + \lambda(n + \phi))} - \frac{Y_f}{\theta}$$

$$M^* = \frac{(\lambda\phi - z\beta)G + (\lambda(\phi + n) + \beta s)(Y_f + \theta Q) - (n\lambda + (s + z)\beta)\phi R_f}{nz + (s + z)\phi}$$

FLEXIBLE EXCHANGE RATE

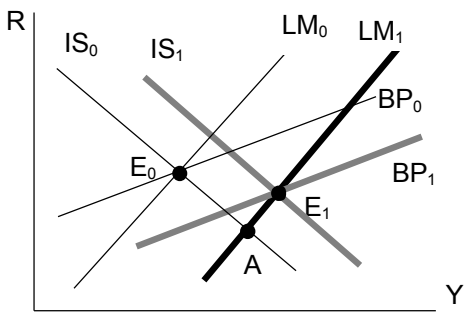
FIXED EXCHANGE RATE



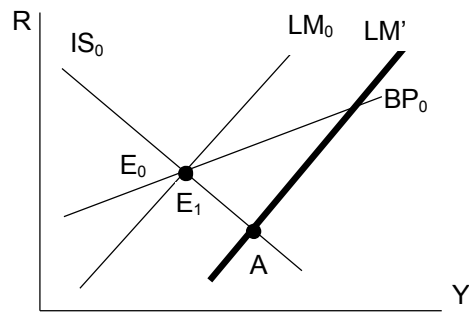
FLEXIBLE EXCHANGE RATE

FIXED EXCHANGE RATE

MONETARY EXPANSION

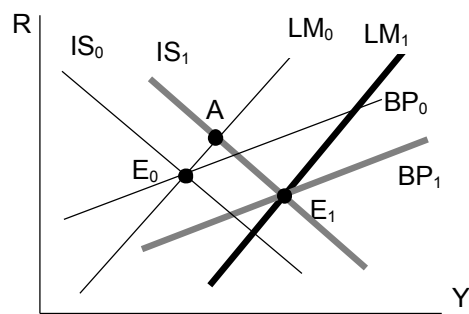


(1) shock : $\uparrow m$ at A : BoP deficit
 (2) adjustment : $\uparrow \$$



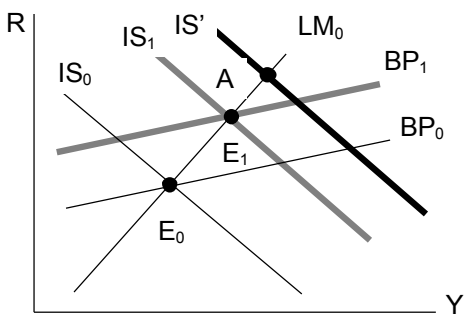
(1) shock : $\uparrow m$ at A : BoP deficit
 (2) adjustment : $\downarrow m$

dévaluation

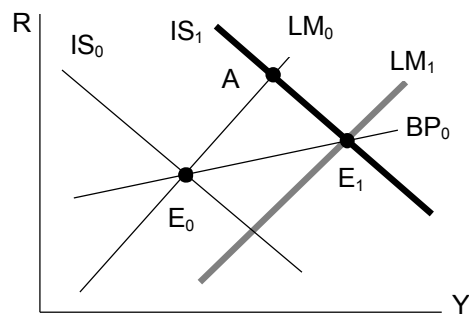


(1) shock : $\uparrow \$$ at A : BoP surplus
 (2) adjustment : $\uparrow m$

BUDGETARY expansion- « HIGH » INTERNATIONAL CAPITAL MOBILITY

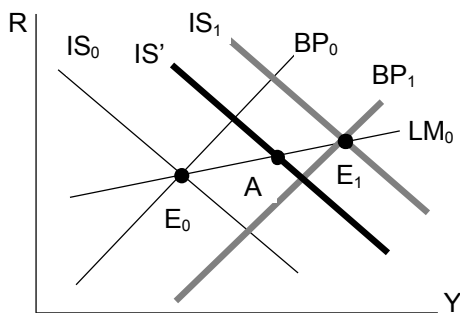


(1) shock : $\uparrow g$ at A : BoP surplus
 (2) adjustment : $\downarrow \$$

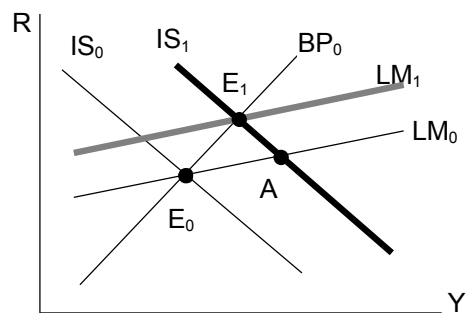


(1) shock : $\uparrow g$ at A : BoP surplus
 (2) adjustment : $\uparrow m$

BUDGETARY expansion- « LOW » INTERNATIONAL CAPITAL MOBILITY



(1) shock : $\uparrow g$ at A : BoP deficit
 (2) adjustment : $\uparrow \$$



(1) shock : $\uparrow g$ at A : BoP deficit
 (2) adjustment : $\downarrow m$