

ch(8)

Relationship among inflation, interest rate, and exchange rate.

xxx: spot rate = .10 \$

\$ → 5%

mexican peso = 6%

$$\rightarrow PP = \frac{1 + i_n}{1 + i_p} - 1$$

$$= \frac{1 + 0.05}{1 + 0.06} - 1 = -0.94\%$$

$$\begin{aligned} \rightarrow F &= S(1 + P) \\ &= .10(1 + -0.94) \\ &= .69906 \$ \end{aligned}$$

~~Relationship among inflation, interest rate, and exchange rate.~~

~~inflation rate.~~

inflation rate.

the exchange rate
policy

[2] purchasing power parity (PPP)

$$* \text{Real} = \text{Nominal} - \text{inflation}$$

← Currency exchange rate

higher inflation lower currency exchange

∴ ...

form PPP.

① ^{Calvo} Absolute form PPP: same products, same prices.
... ..

② ^{Relative} Relation form PPP: same products, different prices.
... ..

* the exchange rate depreciation when

$I_h > I_f$, and the exchange rate depreciation when

$I_h < I_f$

interest rate
↑
holding.

interest rate
↓
foreign currency

for: ...
dep. ...
app. ...

$$e^{\text{real}} = \frac{1 + i_h}{1 + i_f} - 1 \quad / \quad F = S(1 + p)$$

$\swarrow$ forward $\downarrow$ spot

~~240~~

* assume that the home currency experience 5% inflation rate while the foreigner country experience 3% inflation currency, what is the foreigner exchange rate??

$$CF = \frac{1 + i_h}{1 + i_f} - 1$$

داعا تكتب
foreigner //

$$= \frac{1 + 0.05}{1 + 0.03} - 1 = 1.94 \text{ Appreciation for foreigner currency}$$

* assume that the home country experience 4% inflation rate while the foreigner country 7%

$$CF = \frac{1 + i_h}{1 + i_f} - 1$$

$$= \frac{1 + 0.04}{1 + 0.07} - 1$$

$$= -2.8\% \text{ depreciation for foreigner currency}$$

* Consideration for PPP :-

① No Substitute for traded goods: لا يوجد بديل
مستجواب.

② Confunding effects: ارتباك من تغيير سعر الفائدة
والدخل وغيره من المتغيرات.

~~③ International Fisher effect~~

[3] International Fisher effect

تفترض النقطة التالية قبل وتأثير التغير أكثر في إذا تغير
التغير بتغير في (IFE).

* assume that the interest rate in one year
in sure ~~foreign~~ bank deposit is 11%. the interest
home country in one year
in sure foreign
bank is 12%.

$$cf = \frac{1 + i_h}{1 + i_f} - 1$$

$$cf = \frac{1 + 0.11}{1 + 0.12} - 1 = 89\% \text{ Appreciation foreign currency.}$$

* Consideration of IFE:-

- ① The expected inflation rate.
- ② Limitation of PPP.