Lecture session 3
Group work on exercise 1. 3.6. Devaluation or depreciation as a policy objective 3.6.1. Objective(s) and implications 3.6.2. Marshall-Lerner condition 3.6.3. J-curve effect [1] Proposition 1: there are lags in price changes [2] Proposition 2: import prices change faster than export prices in local currency terms [3] Proposition 3: short run changes in the quantity imported and exported are small [4] Implications of propositions 1-3 3.6.4. Devaluation as a policy tool: economic symptoms, macro implications and effectiveness
Study questions: How do changes in hard currencies value affect the terms of trade of countries that have their currencies pegged to the hard currency? What does it mean for a devaluation or a depreciation to be successful? What are the conditions for a devaluation to be successful? Can a devaluation or depreciation be successful in the long run? What is the J-curve and why is it hypothesized to occur? What explains why devaluation first worsens the BOT before it improves the BOT? Why do price changes take time to adjust? What is the Marshall-Lerner condition and what is its meaning in the context of a devaluation? How do the price elasticities of demand and supply matter for the balance of trade?