Eqlbm in Money Mkt and Interest Parity Eqlbm

$E_{kr/\$}$ i_N

Foreign exchange mkt

E^*

$[i_{US}]^e$

0 Kr-returns, i_N

$[MS_N]^0$

Money mkt

$L(i,Y)_N$
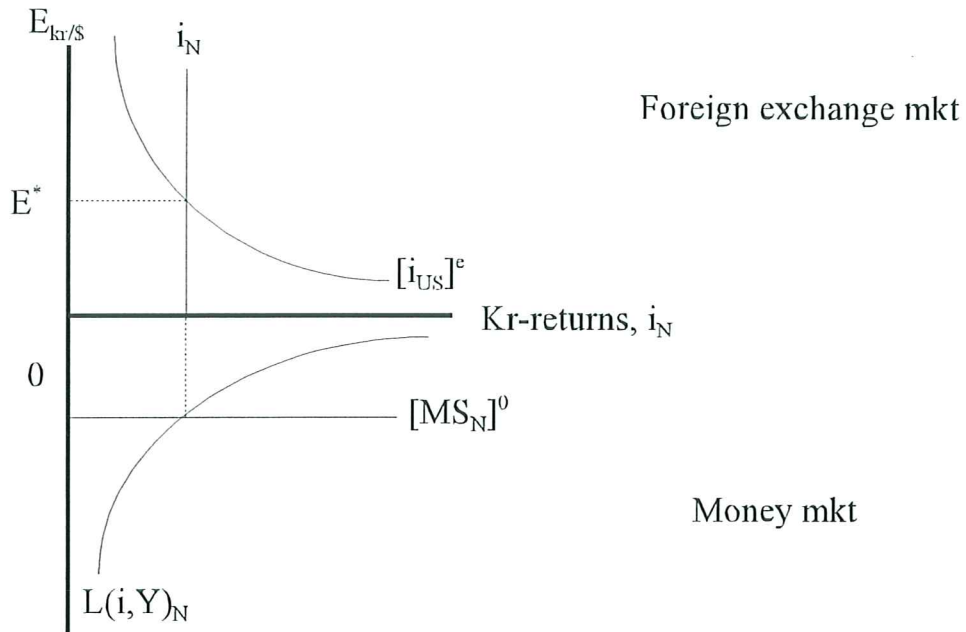
Real MS, MD

Example when ↑ MS_N

① ② ③

↑ MS_N → ↓ i_N ⇒ ↓ kr, ↑ $

$E_{kr/\$}$ $[i_N]^0$

$[E]^1$ ↑ ③

$[E]^0$ $[i_{US}]^e$

0 $[i_N]^1$ ← $[i_N]^0$ interest

②

$[MS_N]^0$

①↓

$[MS_N]^1$

$L(i,Y)_N$
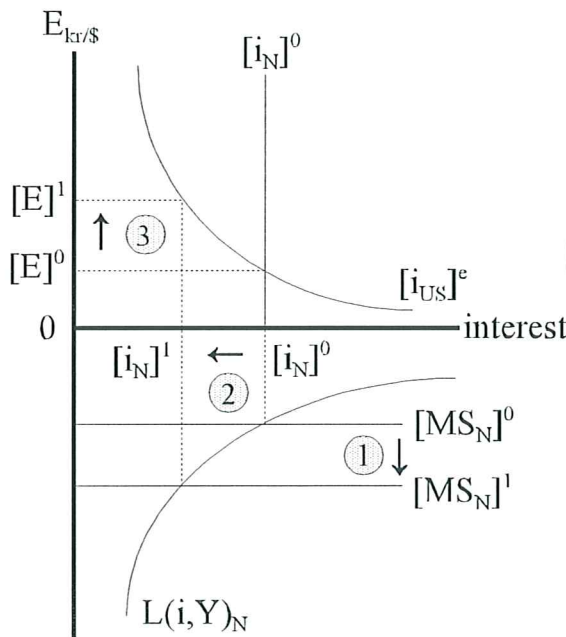
Real MD, MS

Example when ↑ MS_{US}

① ②

↑ MS_{US} → ↓ i_{US} ⇒ ↓ $, ↑ kr

$E_{kr/\$}$ $[i_N]^0$

$[E]^0$

↓②   ①↓ $[i_{US}]^e$

$[E]^1$

$[i_{US}]^{e^1}$

0 $[i_N]$

$[MS_N]^0$

$L(i,Y)_N$
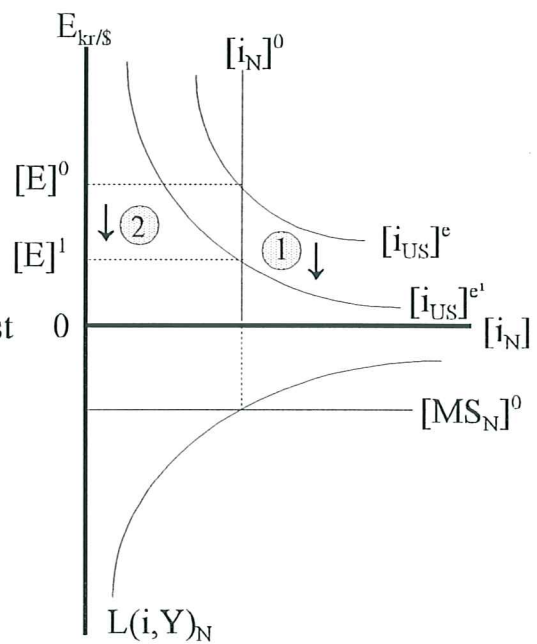
MD, MS

Exchange Rate Overshooting: Adjustment in P from ΔMS

S-R,L-R Effects of Increase in Money Supply (given Q,Y)
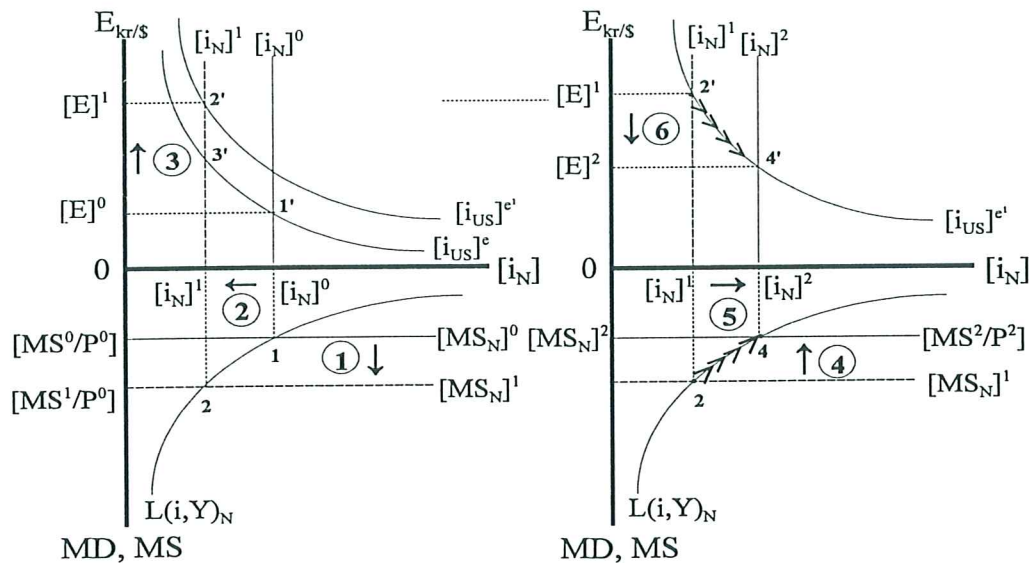
Example of ↑ MS_N

(S-R effects, Norway's Perspective)	(L-R effects, Norway's Perspective)
① ② ③	④ ⑤ ⑥
↑ MS_N → ↓ i_N ⟹ ↓ kr, ↑ \$	↑ $[MS_N]^1$ → ↑ $[P_N]^1$ → ↑ i_N ⟹ ↓ \$, ↑ kr

3' - new eqlbm if expectations on i_{us} don't change