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Mundell-Fleming Lecture: Federal Reserve Policy in an International Context

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A SIMPLE MODEL OF CURRENCY WARS

(1)	$i = i_{US} + e$	Interest-rate parity
(2)	$Y = -ai + bX$	EME IS curve
(3)	$X = -ce + fY_{US}$	EME exports
(4)	$L = \frac{\theta}{2}Y^2 - X$	EME loss function

EME POLICYMAKERS' SOLUTION

(5) $Y^* = c/[\theta(a + bc)] > 0$ Overheating bias

(6) $e^* = -k_0 - k_1 i_{US} + k_2 Y_{US}$ Exchange rate determination

where the k_i are positive constants:

$k_0 = c/[\theta(a + bc)^2],\ k_1 = a/(a + bc),\ k_2 = bf/(a + bc).$

THE GLOBALLY OPTIMAL SOLUTION

(7)	$Y_{US} = -gi_{US} + hX_{US}$	IS curve for the US
(8)	$X_{US} = je$	US exports
(9)	$L = \frac{\theta}{2}Y^2 - X + \frac{\delta}{2}Y_{US}^2$	Global loss function
(10)	$Y_{US} < 0$ and $0 < Y < Y^*$	Social optimum

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