Chapter 23 Elasticities and Absorption

Question 23.4

In 2001 and 2002 the real effective exchange rate of the Brazilian real depreciated sharply.

23.4A What do you think happened to the current account in the short and long run?

23.4B Why is it important for Brazilian policy advisors to know the impact of the depreciation on the current account?

23.4C Explain whether it is important for policy makers to know when the Marshall Lerner condition holds.

Question 23.5

When talking about the J-curve effect, some economists discuss for hours whether foreign producers who produce for the domestic market price denominate their products in foreign currency (producer pricing) or domestic currency (pricing-to-market). Why is this important when talking about the J-curve effect?

Question 23.6

The J-curve shows that a change in the real effective exchange rate leads on average immediately to a change in the price of imported goods. This may not be valid for every individual imported product however. What does the "J"-curve of an individual imported good look like when the foreign producer (who expresses his price in foreign currency) of that good:

23.6A Is a price taker in the domestic market?

23.6B Is a monopolist in the domestic market?

23.6C Uses a cost-price mark-up method to price its goods in the domestic market?

Question 23.7

The German Centre for European Economic Research has an extensive collection of discussion papers on its website. The discussion paper "Exchange rate pass-through to consumer prices: A European perspective" by F.P Hüfner and M. Schröder discusses in a clear way the pass through from the effective nominal exchange rate of the euro to consumer prices of five European countries. Find this paper on the internet and answer the following questions.

23.7A What is the total effect of a change in the effective nominal exchange rate of the euro on the consumer price index of the EMU countries? How long does it take before the total effect on the consumer price index is felt?

23.7B Why does a 1% depreciation of the euro effective exchange rate not lead to a 1% increase of the European consumer price index?

23.7C Why does the adjustment of consumer prices take time?

23.7D How and why does the pass-through between five EMU-members differ?

23.7E Based on the information in the discussion paper, do you think the J-curve is a universal phenomenon?

Question 23.8

The simulation file of question 23.8 shows the impact of a change of the real effective exchange rate of the euro on the current account of France. In 2003 both the average monthly imports and the average monthly exports of France amounted to approximately 40 billion euro. The current account was therefore in balance. As a base scenario the simulation shows the impact on the French current account of a depreciation of the real effective exchange rate of the euro from 1.0 to 1.2 in January 2004.

23.7A Does the baseline scenario show a J-curve effect?

23.7B Explain the change in impact of a depreciation of the real effective exchange rate when

export demand is more price elastic. Explain the change in impact when import demand is more elastic.

23.7C Show what would have happened to the current account of France when the Marshall-Lerner condition was not fulfilled.

Question 23.9

The Marshall-Lerner condition states that a depreciation (appreciation) of the real effective exchange rate leads to a current account improvement (deterioration) when $\varepsilon_x + \varepsilon_y > 1$. This condition is not valid however when the current account initially shows either a surplus or deficit. In this case the condition changes to $\varepsilon_x + \varepsilon_y > 1 + x$. Use the simulation of the J-curve (simulation file of question 23.9) to analyze whether x is positive or negative when the current account initially shows a surplus. Do the same when the current account initially shows a deficit.