

Chapter 31 New Open Economy Macroeconomics

Question 31.4

One of the central puzzles in international economics is the huge fluctuations in the exchange rate not matched by either the interest rates or prices. The researchers Chari, Kehoe and McGrattan of the Federal Reserve Bank of Minneapolis address this issue in their paper “Can sticky price models generate volatile and persistent real exchange rates?”. The table below is taken from their study.

Table: Standard deviation of consumer prices and the nominal exchange rate

	Consumer prices	Nominal exchange rate
France	1.17	8.52
Germany	1.42	8.37
Italy	1.67	8.51
Spain	2.29	8.88
United Kingdom	1.74	8.20

Source: Chari, Kehoe, McGrattan (2002)

- 31.4A How can you derive from the table above that the nominal exchange rate fluctuates more than consumer prices? Why should this surprise you given purchasing power parity?
- 31.4B Can this fluctuation be explained by the Mundell-Fleming model or the Dornbusch model?
- 31.4C Locate the paper of Chari, Kehoe and McGrattan on the internet. Can new open economy models help explain the fluctuation in the nominal exchange rate?