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

Ben Bernanke  
Brookings Institution

Paper presented at the 16th Jacques Polak Annual Research Conference  
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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:

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

# 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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