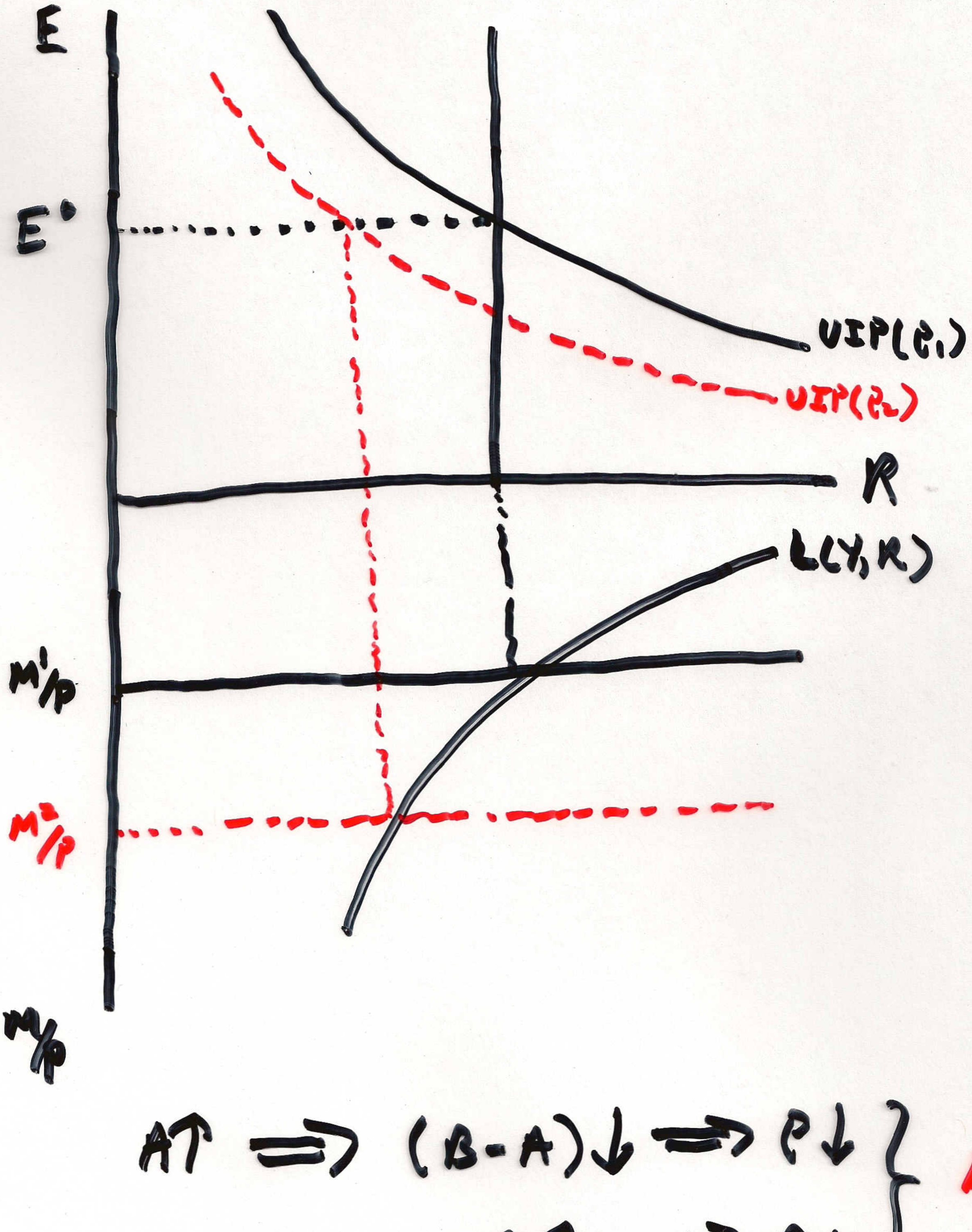
Increasing the Money Supply <u>without</u> Changing E!



$$\left.\begin{array}{l} A\uparrow \;\Rightarrow\; (B-A)\downarrow \;\Rightarrow\; e\downarrow \\ \Rightarrow\; \underset{\text{(unsterilized)}}{M^s\uparrow} \;\Rightarrow\; R\downarrow \end{array}\right\} \Delta E = 0$$

One can think of the Monetary Approach to the BOP as follows:

Money MKt. Equilibrium

$$M^s/P = L(R, Y)$$

Definition of the Money Supply

$$M^s = \mu \cdot (F + A)$$

F = Foreign Assets
A = Domestic Assets
μ = Money Multiplier

Therefore,

$$F = \frac{1}{\mu} P \cdot L(R, Y) - A$$

If μ is constant,

$$\boxed{\begin{aligned} \Delta F &= \text{BOP Surplus} \\ &= \frac{1}{\mu} \Delta [P \cdot L(R, Y)] - \Delta A \end{aligned}}$$

The Monetary Approach is most useful when BoP imbalances arise directly from imbalances in the money market.