Increasing the Money Supply without Changing $E$!

\[ \Delta E = 0 \]

\[ AT \Rightarrow (B-A) \downarrow \Rightarrow P \downarrow \]

\[ \Rightarrow M^s \uparrow \Rightarrow R \downarrow \]

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

Money Market Equilibrium

\[ M_s/p = L(R, Y) \]

Definition of the Money Supply

\[ M_s = \mu (F + A) \]

\( F = \text{Foreign Assets} \)
\( A = \text{Domestic Assets} \)
\( \mu = \text{Money Multiplier} \)

Therefore,

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

If \( \mu \) is constant,

\[ \Delta F = \text{BOP Surplus} \]

\[ = \frac{1}{\mu} \Delta [P\cdot L(R, Y)] - \Delta A \]

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