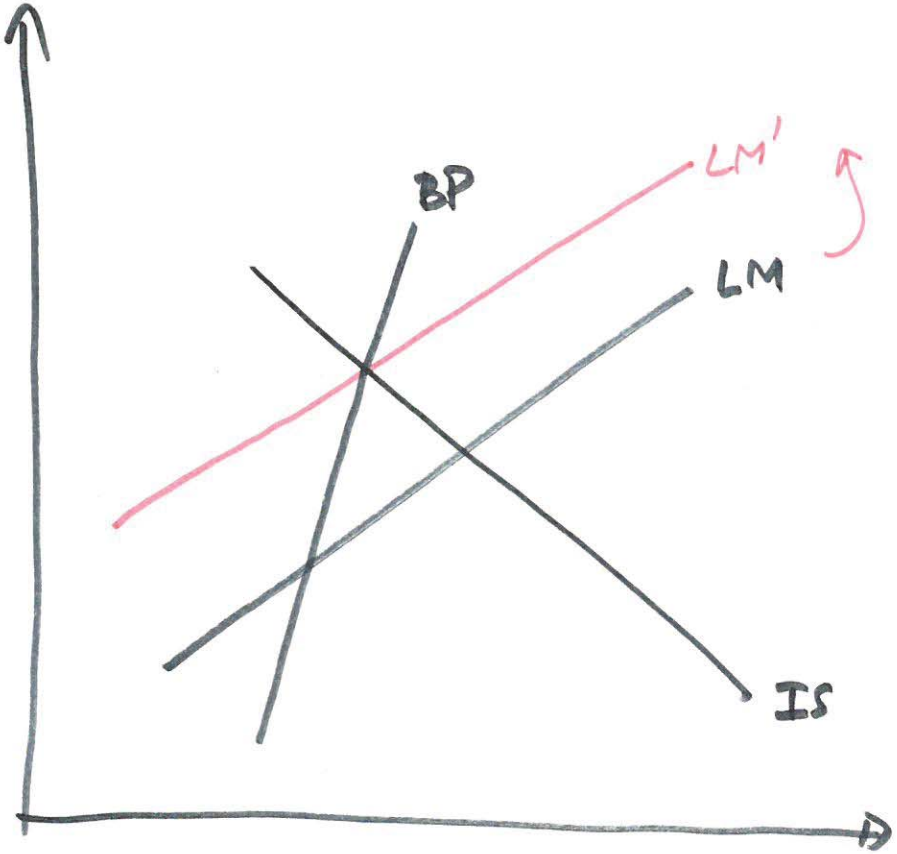
figure 2.1



under the fixed exchange rate system, CB intervens the forex market.

They sell USD to fix the BoP deficit and sustain (maintain) the fixed exchange rate.

This brings about a drop in money supply; LM shift left.

figure 2.2

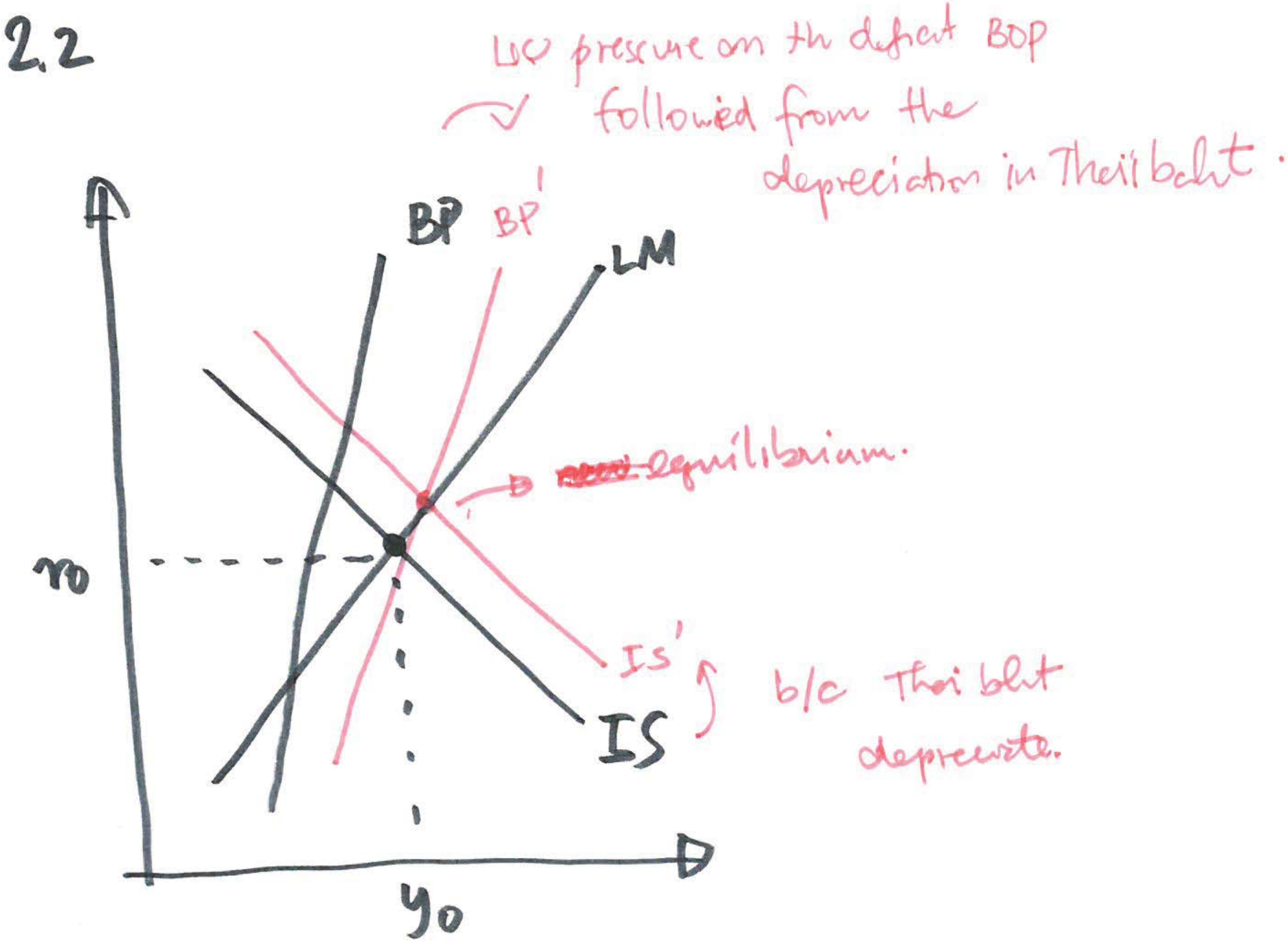
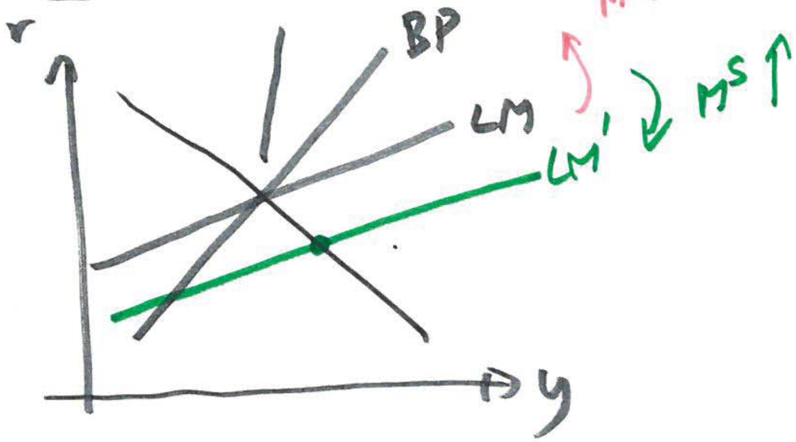

Less pressure on the deficit BOP
followed from the
depreciation in Thai baht.
BP
BP'
LM
equilibrium.
r0
IS'
IS
b/c Thai baht
depreciate.
y0

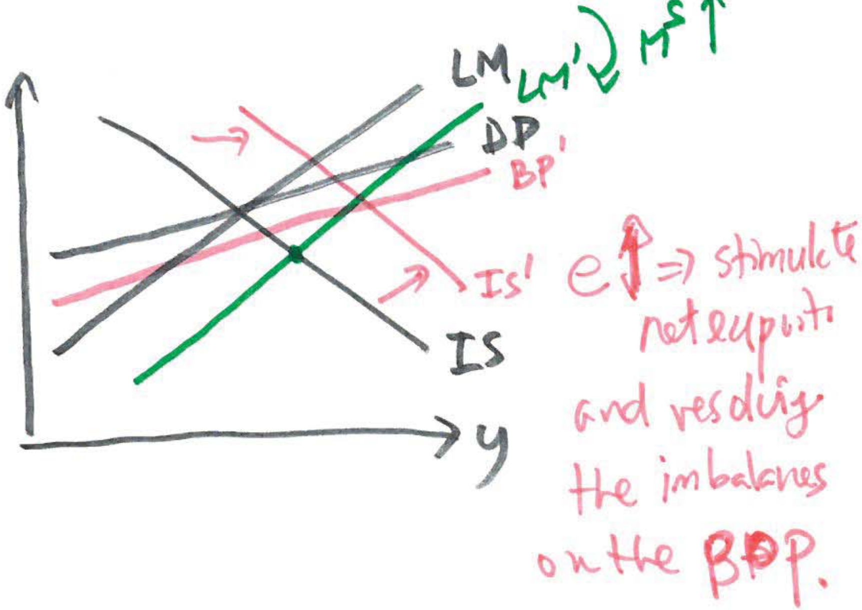
figure 3.1

$M^S\downarrow$ under fixed exchange rate

Case 1



Case 2



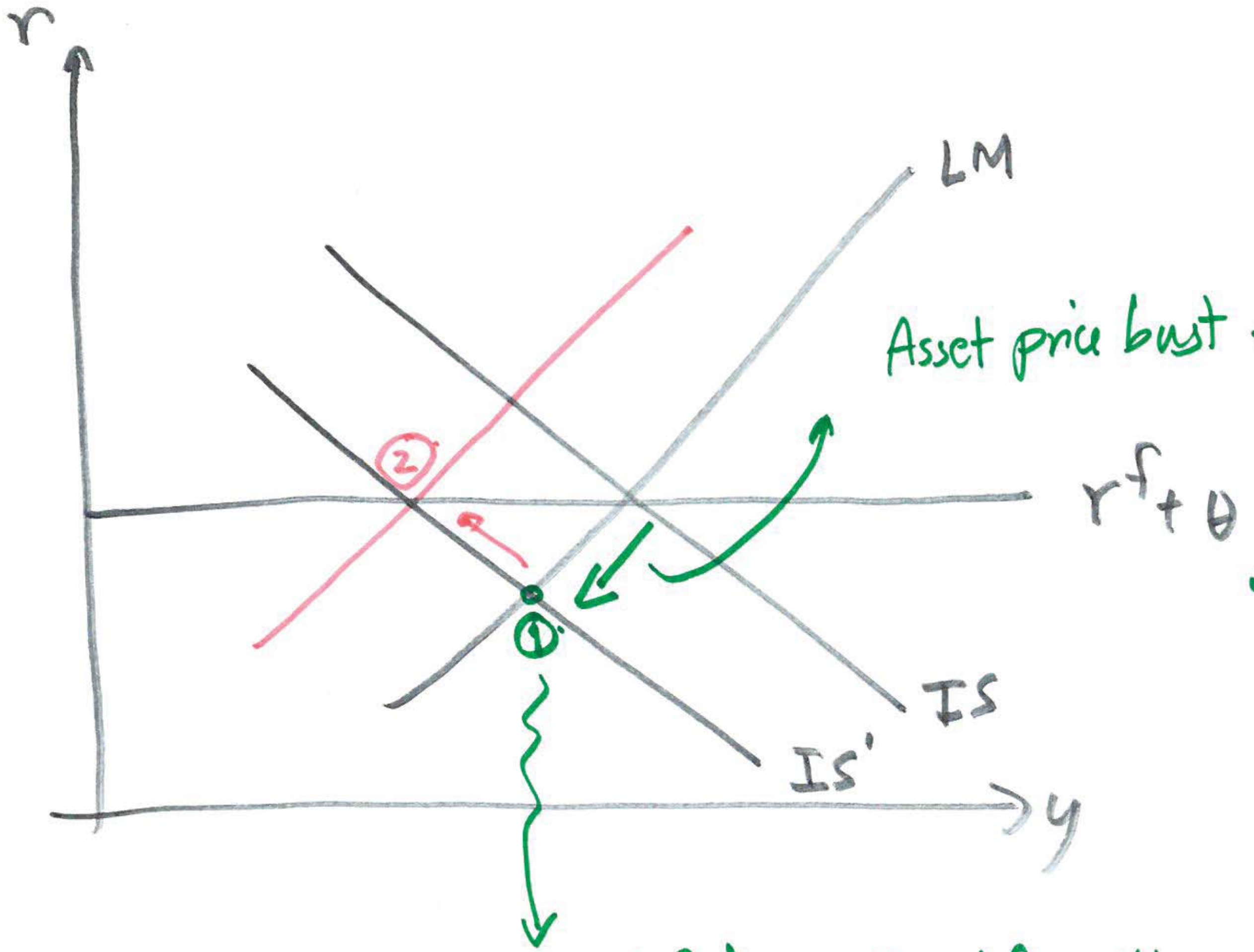
In both cases, an increase in money supply causes a decrease in the interest rate; this brings about a balance of payment deficit in any case.

The adjustment process would be similar then.

That is, it will depend on the regime of exchange rate.

If the exchange rate system is fixed, money supply will be adjusting. But if the exchange rate is flexible, the depreciation of exchange rate will resolve the external imbalance, and hencing gravitating the economy towards open-economy equilibrium.

Figure 4.1



Asset price bust → decline in consumer's wealth.

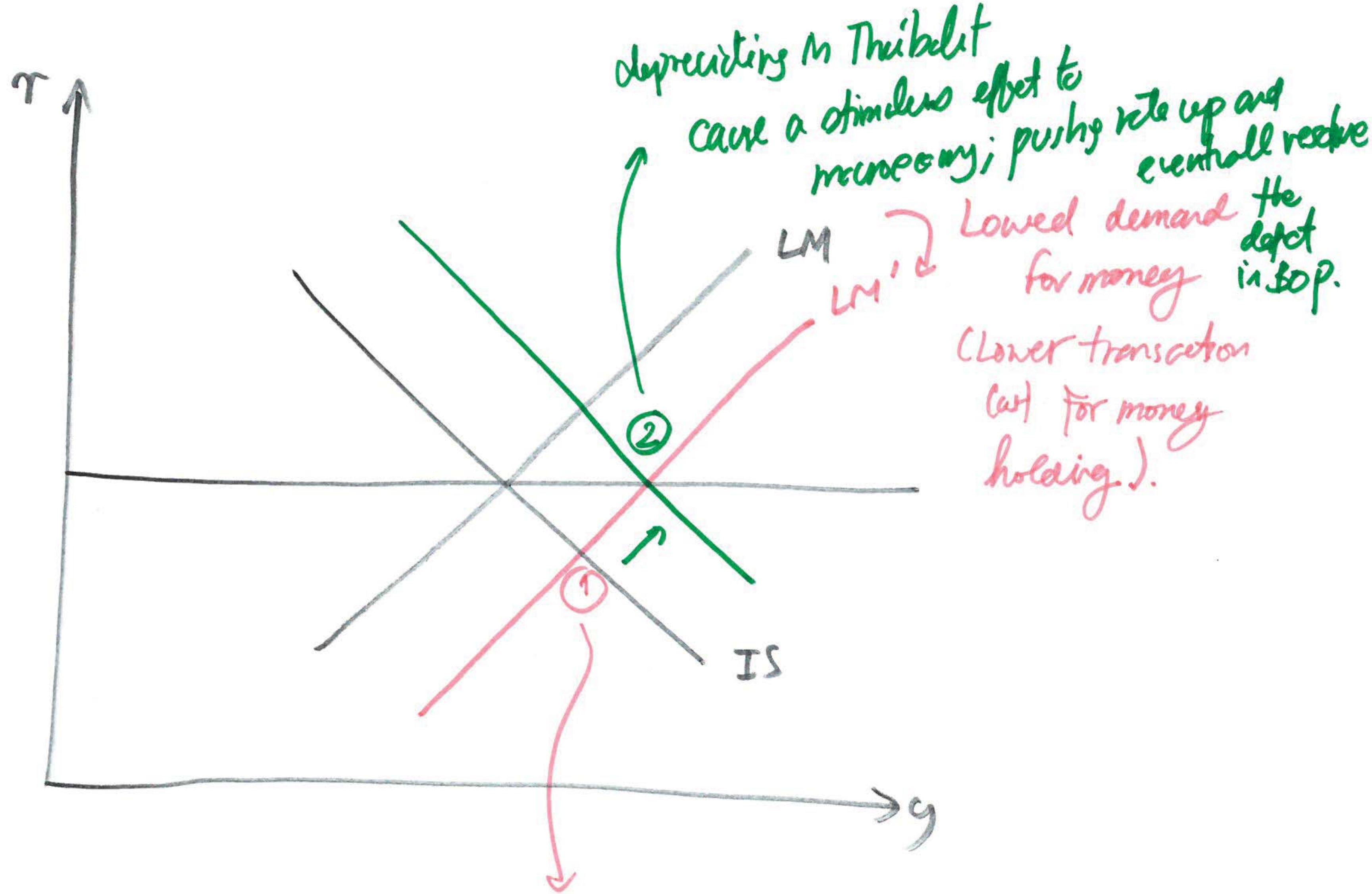
⇓

"Spending cut followed

BOP deficit → Capital outflow.

Prevent baht from depreciate → sell USD → $M^S \downarrow$ Captured by the red LM.

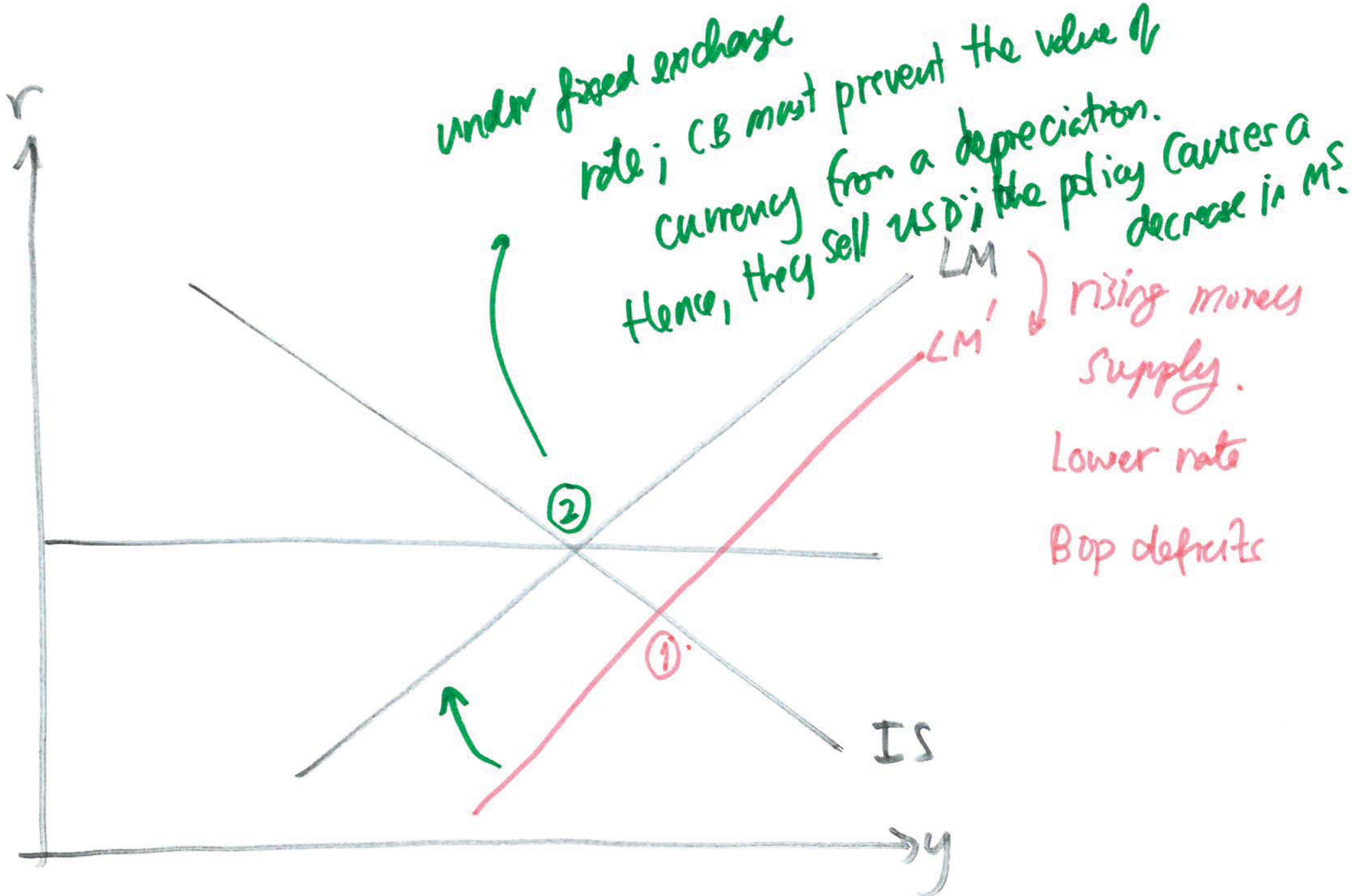
Figure 4.2.



① BoP deficits.

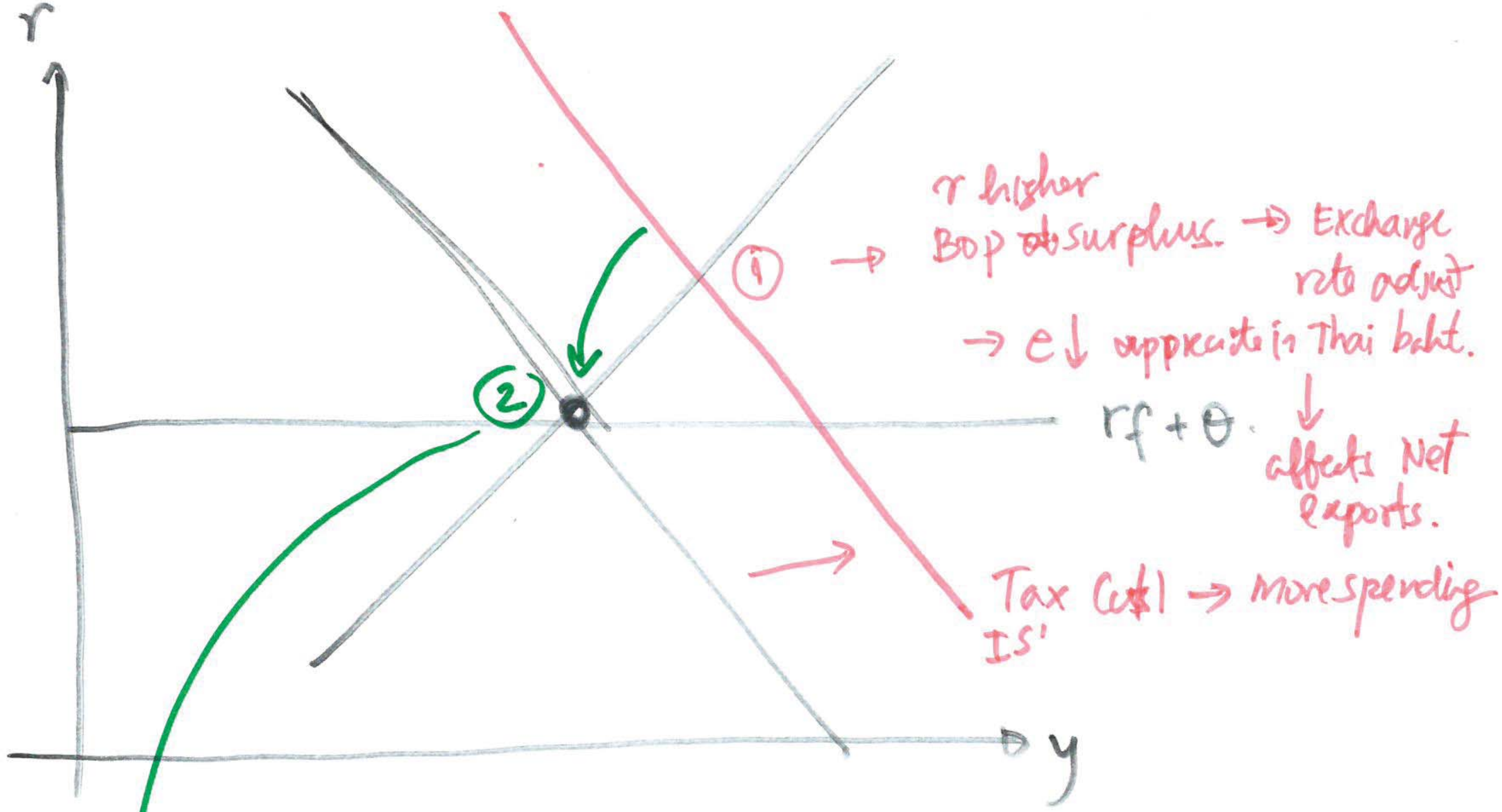
② → Under flexible; e↑ ; Thai baht depreciate

Figure 43



r
y
LM
LM'
IS
2
1
under fixed exchange rate; CB must prevent the value of currency from a depreciation. Hence, they sell USD; the policy causes a decrease in M^S.
rising money supply.
Lower rate
BoP deficits

Figure 4.4



The decline of net exports, owing to an appreciation of Thai bath, would offset the initial impact of tax cut. The economy returns to the original situation.