# Notes — Week 14

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Period 3

1. Open Economy
   - $AD = C + I + G + \boxed{NX} \longleftarrow$ focus of this chapter
2. Four Factors in an Open Economy:
   (a) Balance of Payments
   (b) Exchange Rates
   (c) Role of Central Bank
   (d) Barriers to Trade
3. Some Basics:
   - Countries don't trade with each other — people do
   - Financial capital (money) flows all around the world seeking the highest possible return
   - In the 21$^{st}$ century, making a financial investment in another country is a simple click away
   - People want to be paid in their domestic currency
4. Balance of Payments Accounts — A summary of the country's transactions with other countries. There are two main types of transactions:
   (a) People trading currently produced goods or services for money
   (b) People trading pre-existing assets for money
5. Capital Account — Flow of currently produced goods and services
   - Net exports
   - Net financial investment income (income and dividend income)

- Net transfers (remittances and foreign aid)

6. Financial Account — Flow of Financial Capital (Pre-existing Assets)

   - Real assets
   - Financial assets

7. A deficit in one will be matched by a surplus in the other: $CA + FA = 0$

8. Debits and Credits

   - Debit (-) — Any transaction that requires foreign currency (*i.e.* imports, money outflows)
   - Credit (+) — Any transaction that earns foreign currency (*i.e.* exports, money inflows)

9. Foreign Exchange

   - An increase in the demand for one currency results in an increase in supply for another

10. Determinants of Demand for Currency

    - Tastes and preferences
    - Price Level — Inflation tends to depreciate currencies (don't conflate domestic monetary policy and foreign exchange markets)
    - National income and relative income changes
    - Interest rates
    - Speculation/expectations