

浙江工商大學

Undergraduate Dissertation



Title: The Effects of Government Spending on Real Exchange Rates

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中文摘要

本文采用OCED中34国的数据，构建了一个计量模型，检验政府支出对实际汇率的影响。...

关键词： 政府支出； 实际汇率； 面板数据

Abstract

Using panel data on military spending for 125 countries, we document new facts about the effects of changes in government purchases on the real exchange rate, consumption, and current accounts in both advanced and developing countries. While an increase in government purchases causes real exchange rates to appreciate and increases consumption significantly in developing countries, it causes real exchange rates to depreciate and decreases consumption in advanced countries. The current account deteriorates in both groups of countries. These findings are not consistent with standard international business-cycle models. We investigate whether the difference between advanced economies and developing countries in the responses of real exchange rates to spending shocks can be explained by alternative hypotheses.

Keywords: Government Expenditure; Real Exchange Rate; Panel Data

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1 Introduction

How does government spending affect the current account and the real exchange rate? Conventional wisdom—as well as mainstream macroeconomic models used by policymakers—suggests that an increase in government spending puts pressure on the domestic currency to appreciate, leading to current account deterioration (and potentially a “twin deficit”) and to a decrease in consumption through an international risk-sharing condition. This mechanism holds across a wide range of models, including both New Keynesian and neoclassical models. However, empirical evidence for such a mechanism has not been settled. For example, Corsetti and Müller (2006) and Kim and Roubini (2008) find that in the U.S. data the trade balance improves after a government spending shock. In contrast, using the data for Australia, Canada, the United Kingdom, and the United States, Monacelli and Perotti (2010) and Ravn, Schmitt-Grohé, and Uribe (2012) estimate that a rise in government spending causes a trade deficit, as well as a real depreciation of the domestic currency and an increase in consumption. Given these contrasting empirical results in studies of a relatively small number of countries, several questions on the effects of government spending in an open economy remain: First, does government spending cause the domestic currency to appreciate in real terms and does it worsen the current account? Second, do the effects of government spending shocks differ across countries, especially between advanced and developing countries? Third, are there any other country characteristics, such as the exchange-rate regime or the degree of openness to trade, that can affect the

transmission mechanism of government spending shocks? This paper addresses these important questions using a large data set for 125 countries between 1989 and 2013. We provide new evidence on the effects of government spending on the real exchange rate, current account, and consumption. Importantly, we exploit the information in both advanced and developing countries to distinguish between the effects of government spending in these two groups. Our data also let us examine the differential effects of government spending depending on exchange-rate regimes and the level of trade openness. Since government spending can affect the state of the economy and vice versa, we identify government spending shocks using exogenous variation in international military spending. This approach has been used in the closed economy literature (Hall 2009, Barro and Redlick 2011, Ramey 2011), but remains under utilized in the open-economy literature.

1.1 Research Background

We document a number of new empirical facts: First, in response to a positive government spending shock, the real exchange rate appreciates on impact, and the effect is significant up to a two-year horizon. After an increase in government spending of 1 percent of GDP, the real exchange rate appreciates by over 3 percent on impact and by up to 5 percent two years after the shock. The effect is most pronounced in countries with a flexible exchange-rate regime. Consistent with Monacelli and Perotti (2010), we also find that the current account deteriorates significantly in response to a positive government spending shock. Consumption increases substantially, peaking at about 5 percent two years after the change in

government spending.

2 Literature Review

A literature review is a text of a scholarly paper, which includes the current knowledge including substantive findings, as well as theoretical and methodological contributions to a particular topic. Literature reviews are secondary sources, and do not report new or original experimental work. Most often associated with academic-oriented literature, such reviews are found in academic journals, and are not to be confused with book reviews that may also appear in the same publication. Literature reviews are a basis for research in nearly every academic field¹. A narrow-scope literature review may be included as part of a peer-reviewed journal article presenting new research, serving to situate the current study within the body of the relevant literature and to provide context for the reader. In such a case, the review usually precedes the methodology and results sections of the work.

2.1 Empirical Research

Producing a literature review may also be part of graduate and post-graduate student work, including in the preparation of a thesis, dissertation, or a journal article. Literature reviews are also common in a research proposal or prospectus (the document that is approved before a student formally begins a dissertation or thesis).

¹This part is borrowed from Wikipedia.

2.2 Theoretical Research

3 Model Economy Setup

3.1 Households

The household intends to maximize the following objective utility throughout her lifetime.

$$U_t = E_t \sum_{t=0}^{\infty} \beta^t \log C_t - \varphi_t \frac{L_t^{1+\phi}}{\phi}, \quad (1)$$

where E_t is mathematical expectation operator, C_t is consumption bundle. The objective utility (1) is subject to the following constraint.

$$P_t C_t \leq W_t L_t + Tr_t, \quad (2)$$

3.2 Producers

4 Econometric Results

This is how you represent econometric results.

4.1 Result Report

Table 1: Performance Using Hard Decision Detection

Audio Name	Sum of Extracted Bits						
Police	5	-1	5	5	-7	-5	3
Midnight	7	-3	5	3	-1	-3	5
News	9	-3	7	9	-5	-1	9

This section examines important cases that can affect our baseline results. In particular, we analyze whether wars, financial crises, commodity prices, and the type of military spending can significantly influence our baseline results. We also

show that our results are robust to adding potentially important controls to the regression.

5 Figure

This is how to insert picture.



Figure 1: Zhejiang Gongshang University Old Logo

Language is an interesting subject ([Trang and Mebkhout, 1983](#)). There are commands for in-text citations, like [Goresky and MacPherson \(1981\)](#). And you can pass an option to specify additional details, such as a page or chapter number, as an option ([Fulton, 1983](#), p. 130).

A very important reference in financial accelerator is ([Bernanke et al., 1999](#)) and [Bernanke et al. \(1999\)](#).

Reference

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Appendix