

Exercises

1. Assume the following process for the price level $p_t = \phi_0 + \phi_1 m_{t-1} + \phi_2 u_t$. Money follows $m_t = m_{t-1} + \mu$, and money demand can be given written as $m_{t-1} + \mu = \gamma + \alpha E_t p_{t+1} + (1 - \alpha)p_t + u_t$ (u_t - white noise, $E_t u_t = 0$). Determine the price level p_t , using the the method of indeterminate coefficients. How can you characterize the relation between prices and money on the basis of the obtained result?
2. Assume the following process for the price level $p_t = \omega_0 + \omega_1 p_{t-1} + \omega_2 u_t + \omega_3 u_{t-1}$. Money follows $m_t = m_{t-1} + \mu$, and money demand can be given written as $m_{t-1} + \mu = \gamma + \alpha E_t p_{t+1} + (1 - \alpha)p_t + u_t$ (u_t - white noise, $E_t u_t = 0$). Determine the price level p_t , using the the method of indeterminate coefficients and discuss the results.
3. In the context of the Fiscal Theory of the Price Level, explain succinctly the difference between a Ricardian and a non-Ricardian fiscal regime.
4. Consider the government budget constraint $\Delta b = d - nb$ (b - debt ratio; d - deficit ratio; n - nominal economic growth rate). Assume that countries A and B face the same nominal growth rate of 5%, and that both choose to stabilise their debt ratios respectively at 100% and 40%. Compare and comment on the deficit ratio that each country is committing to, notably in the light of the Stability and Growth Pact framework.
5. Explain succinctly in what consists the sustainability of fiscal policy and what are the main determinants of such sustainable fiscal behaviour.