Lecture #22 – Monday, March 29, 2004

ADVANCES FROM THE BANK OF CANADA

Suppose the reserve rates at the chartered banks fall below the desired ratio. They borrow funds from the Bank of Canada:

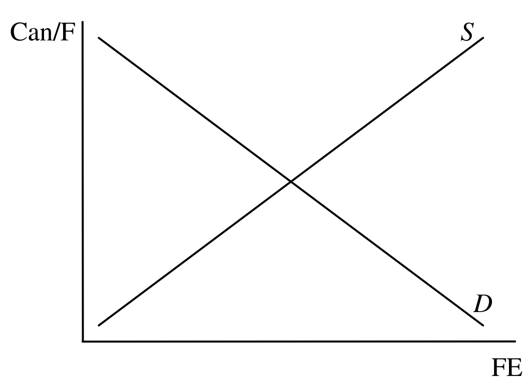
Chartered Banks		Bank of Canada	
Reserves: +100 (DD at Bank of Canada)	Advances from Bank of Canada: +100	Advances to Chartered Banks: +100	DD: +100 (Chartered Banks)

- No direct increase in the money supply – rare case, usually repaid quickly.
- Bank Rate: Interest rate charged by the Bank of Canada for advances.
    - Reflects the short-term interest rates – influences the interest rates.
    - Can either encourage/discourage banks to keep reserves – indirectly expand or contract money supply.

FOREIGN EXCHANGE MARKET

	Canadian Dollars	Foreign Exchange
Import ↑:	Supply ↑	Demand ↑
Export ↑:	Demand ↑	Supply ↑
Capital Inflow ↑:	Demand ↑	Supply ↑
Capital Outflow ↑:	Supply ↑	Demand ↑

EXCHANGE RATE SYSTEMS

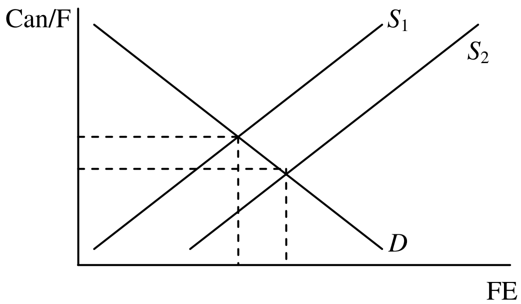


Consider a rise in Can/F. Foreign exchange is now more valuable:

- S is positively sloped: X↑, FE supplied ↑.
- D is negatively sloped: M↓, FE demanded ↓.
- Depreciation in Canadian dollars.

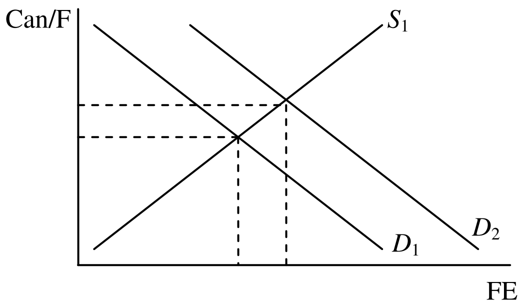
Flexible Exchange Rates

Government doesn't intervene – demand and supply determine the exchange rate.



Canadian dollars appreciates:

- Increase in export demand.
- Capital inflow.
- Increase in Canadian interest rates – attracts lenders.

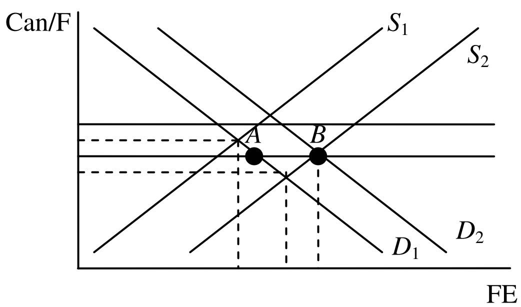


Canadian dollars depreciates:

- Increase in import demand.
- Capital outflow.

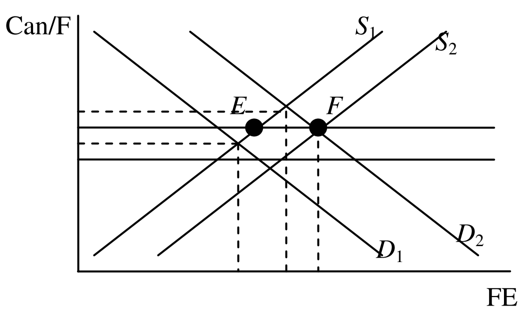
Fixed Exchange Rate

Government intervenes to keep a fixed exchange rate.



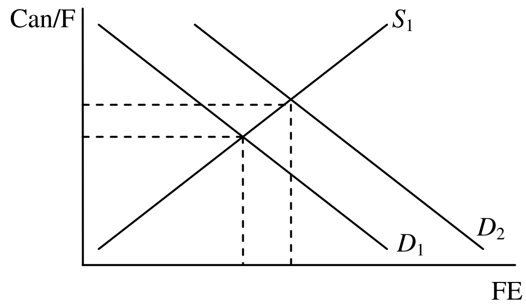
Suppose there is a huge increase for exports:

- *AB* excess supply of foreign exchange.
- Bank of Canada buys foreign exchange and sells Canadian dollar.
- Foreign Exchange Reserves increases.



Suppose Canada wants to travel more (increase in imports):

- *EF* excess demand for foreign exchange.
- Bank of Canada sells foreign exchange and buys Canadian dollar.
- Foreign Exchange Reserves decreases.



Can/F
S_1
D_2
D_1
FE