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### Chapter 14 Asset markets, exchange rates and the balance of payments

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#### Publisher Summary

This chapter reviews developments in international monetary economics from the late 1960s through the early 1980s. It discusses that the "monetary approach to the balance of payments" was the economic determinants of the behavior of the balance of payments, especially, the theoretical elaboration and empirical investigation of the dynamic mechanism of balance of payments adjustment. Recent research on macroeconomics, for both closed and open economies, expresses far less confidence in the ability of governments to systematically affect levels of national income and consistently maintain full employment through policy manipulation. The chapter discusses that in earlier work on exchange rate theory, the condition for equilibrium in the flow market for foreign exchange transactions has been regarded as the proximate determinant of the exchange rate. In some analyses, expectations of future exchange rates had an important influence on current exchange rates by affecting speculative

capital flows. The chapter also provides modern analysis of the dynamics of balance of payments adjustment under fixed exchange rates beginning with a simple exposition of the key elements of the monetary mechanism of balance of payments adjustment. Finally, the chapter also deals with the theory of flexible exchange rates. The evolution of the international monetary system from a regime of pegged exchange rates into a regime of flexible rates resulted in a renewed interest in the theory of exchange rate determination.



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