

UNIVERSITY OF MARYLAND
Department of Economics

Economics 754 – Political Economy in Macroeconomics

Exercise 4

1. In the Rogoff model in Section 6.7 in PEM, show how Bayes' Rule is used to derive the expected rate of inflation in (6.24).
2. Show why it is not optimal for all types with $c < 1$ to inflate immediately. (Hint: What must be true about the magnitude of π_t^e in order for (6.23) to hold?)
3. Derive (6.25) and draw a picture.
4. Derive formally the critical value in (6.30).