differential effects.

Proposition 4. An increase in α^2 *causes*

a. a decrease in $g(c/c^*)$ *if* $\bar{p}<p/e$

b. an increase in $g(c/c^*)$ *if* $\bar{p}>p/e$.

Less confidence with the forecast based on purchasing power parity leads consumers to place greater weight on $\bar{p}$ to calculate expected foreign price. If $\bar{p}<p/e$, then consumers anticipate that foreign prices will fall, leading consumers to increase purchases of foreign goods while domestic consumption falls. If $\bar{p}>p/e$, then consumers believe foreign prices will rise which favors domestic consumption rather than foreign consumption.

The results of propositions (1)-(4) are summarized in Figure 2, which illustrates how the consumer allocates income between goods purchased in the domestic market and abroad, for given values of p, y, and θ. The function $g(\cdot)$ is increasing which suggests that higher forecasted foreign price leads to greater domestic consumption. A change in uncertainty causes the curve to rotate around point A where $\bar{p}=p/e$. An increase in the value of θ (either due to a decrease in γ^2 or an increase in α^2) causes the curve to rotate clockwise as indicated by the dotted line. In this case, consumers rely more heavily on $\bar{p}$ in forming expectations of foreign price. If $\bar{p}>p/e$ then consumers anticipate higher prices abroad and reduce foreign expenditures. But if $\bar{p}<p/e$, the change in uncertainty leads consumers to believe that foreign prices have fallen which favors increased travel spending. Only when $\bar{p}=p/e$ is the consumer's choice unaffected by uncertainty.