Econ 116
Problem Set 9
Due November 28, 2017

Flexible Exchange Rates

1. Say that China appreciates it currency and in the quarter following this its current account improves. Is this inconsistent with the theory that an appreciation decreases a country's exports and increases it imports? Explain.
2. What are the first round effects on the domestic price level in a country if its currency is appreciated? Explain using the AS/AD model.
3. If in a suprise announcement the Fed said it was lowering the interest rate, what effect is this likely to have on the value of the dollar vis a vis other countries' currencies and why?
4. In what sense is fiscal policy possibly less effective under flexible exchange rates than under fixed exchange rates? What about monetary policy?

Financial Crises

Answer one of the two following questions

1. There are a number of examples in the last 30 years where a country tried to keep its exchange rate fixed (usually relative to the U.S. dollar) that led to a crisis and forced the country to abandon the fixed rate. Explain in general why this might happen and then briefly discuss one example in history where it actually happened. In your example, roughly how much did the value of the exchange rate change in the first two months when the country abandoned the fixed rate? How did the country do economically in the two years following the depreciation?
2. There are a number of small countries in the world that fix their exchange rate to another currency (dollar, euro, etc.), thus giving up their monetary policy. Choose one of these countries and discuss how it is doing economically—real output, inflation, unemployment rate, government deficit, current account, etc.