

Econ 116b
Problem Set 9

Flexible Exchange Rates

1. Say that in the quarter following a depreciation of country A's currency its current account worsens. Is this inconsistent with the theory that a depreciation increases a country's exports and decreases its imports? Explain.
2. If the Fed announces a surprise increase in the U.S. interest rate, why might this lead to an appreciation of the dollar?
3. 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 when the country abandoned the fixed rate?
4. China holds billions of dollar denominated assets. Should it be concerned about a possible depreciation of the dollar over time? Explain.
5. In what sense is fiscal policy possibly less effective under flexible exchange rates than under fixed exchange rates?
6. What are some of the economic costs and benefits of England joining Euro-land?