

EE 452: International Monetary Economics
Fall 2014

Homework 2
(due October 14, 2014@ BE office)

1. Using figures for both the short run and the long run, show the effects of a permanent increase in the U.S. money supply on dollar-euro exchange rate. Try to line up your figures to the short and long run equilibria side by side. Assume that the U.S. real national income is constant.
2. Using 4 different figures, plot the time paths showing the effects of a permanent increase in the Singapore's money supply on:
 - A. Singapore money supply.
 - B. the Singapore interest rate.
 - C. the price level in Singapore.
 - D. the Singapore dollar/Baht exchange rate.
4. Suppose a Big Mac at a McDonald's in New York costs \$2.50 and FFr 15 in Paris.
 - a. What spot exchange rate establishes the Law of One Price for these two commodities?
 - b. If the current spot exchange rate is FFr 5/\$, what is the real exchange rate? What are the units of the calculation?
 - c. According to your calculation, is the dollar over- or under-valued? How about the French franc?
5. Suppose the expected annual inflation rate in the UK is 4.5% and that in the US 3%. According to PPP, will the dollar appreciate or depreciate? By which percentage?
6. Suppose the current spot rate is \$ 1.55/£ on the first of January. By year's end, the US CPI is expected to climb from 144 to 150 and the UK CPI is expected to climb from 120 to 130. According to PPP, what is the expected spot rate on December 31?