EE 452: International Monetary Economics
Winter 2014

Homework 2
(due May 23, 2015)

1. How does the DD schedule shift if there is a decline in investment demand?

2. Suppose the government imposes a tariff on all imports. Use the DD-AA model to analyze the effects this measure would have on the economy. Analyze both temporary and permanent tariffs.

3. Suppose there is a permanent fall in private aggregate demand for a country's output (a downward shift of the entire aggregate demand schedule). What is the effect on output? What government policy response would you recommend?

4. How does fiscal expansion affect a country's current account under a fixed exchange rate?

5. Explain why temporary and permanent fiscal expansions do not have different effects under fixed exchange rates, as they do under floating.

6. Using the DD-AA model, analyze the output and balance of payments effects of an import tariff under fixed exchange rates. What would happen if all countries in the world simultaneously tried to improve unemployment and the unemployment by imposing tariffs?

7. Explain how a central bank can perform a sterilized exchange rate intervention and what would happen to domestic money supply, central bank's domestic assets, and central bank's foreign assets in the following situations

    a. The central bank realizes that the value of the local currency is too weak.
    b. Domestic output rises.
    c. Foreign country's output falls, assuming that they have floating exchange rate.

8. Use a diagram to explain how a central bank can alter the domestic interest rate, while holding the exchange rate fixed, under imperfect asset substitutability.