

EE 452: International Monetary Economics  
Winter 2014

Homework  
(due at the BE Office on May 7, 2014)

1. Use PPP and Money Market Equilibrium to produce the time path explaining the effect of an increase in the European money supply growth on the EU Money Supply,  $R_{eu}$ , Price Level and Spot Exchange Rate in terms of  $\text{€Aus\$}$  over time. Assume inflation in the EU. is constant at 2%.
2. Suppose the monetary authority raises money supply to fight the recession of a country. Use the DD-AA model to analyze the effects this measure would have on the economy with floating exchange rate. What are the differences between temporary rise and permanent rise?
3. Suppose the government under floating exchange rate regime imposes a tariff on all imports. Use DD-AA model to analyze the effects this measure would have on the economy. Analyze both temporary and permanent tariffs.
4. Suppose there is a permanent fall in private aggregate demand for a country's output. What is the effect on output? What government policy response you would recommend?
5. 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.
6. How does fiscal expansion affect a country's current account under a fixed exchange rate?
7. Explain why temporary and permanent fiscal expansions do not have different effects under fixed exchange rates, as they do under floating.
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.