

Final Exam
International Economics 446/546

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May 15, 2007

Name _____

Answer **7** of the following 9 questions. Please answer each question True, False, or neither and explain the reasons for your answers. **Use graphs and/or equations in your explanations whenever possible.** Required graphs and equations are listed in brackets. Be sure to **label all graphs** and to **define any economic terms** in the statements. Credit for each question depends entirely on your explanations.

1. The US current account deficit can rationally be explained as caused by a strong increase in expected future income growth. [Use AA-DD-XX curves and consider both sticky prices and flexible prices.]
2. Emerging market country current accounts are driven by consumption-smoothing, growth, and relatively volatile output. Therefore, emerging market countries should experience systematic current account deficits and their current account balances should be more volatile output than those in industrial countries. [National income accounting identity and AA-DD-XX curve with flexible prices.]
3. A country which wants to stabilize output around a full employment level and keep inflation low would prefer fixed exchange rates to flexible rates if most of its shocks were to the DD curve rather than the AA curve. [AA-DD-XX curves]
4. With flexible exchange rates monetary expansion at home increases output in both the home and foreign countries in the short run. In the long run, domestic and foreign prices both rise and both outputs return to their initial levels. [AA-DD-XX curves for domestic country and equation for goods market equilibrium for foreign country.]
5. Assume that a country has been running a current account deficit. A sudden stop in capital flows requires a current account surplus, real exchange rate depreciation, and an increase in the domestic interest rate to satisfy interest rate parity. [domestic saving investment diagram with CA deficit and equation for interest rate parity]
6. A country which decides to join the European Monetary Union expects an enhanced ability to stabilize its output around the full employment level and keep inflation low compared with its initial ability under flexible exchange rates.

7. Under fixed exchange rates, a permanent increase in government spending, initially without tax financing, appreciates the real exchange rate, creates a current account surplus, and sets the country on the path to an exchange rate crisis. [AA-DD-XX curves with flexible prices]
8. A currency crisis is more likely in a recession. [AA-DD-XX curves in extended model]
9. US monetary policy to increase the interest rate will create recession and current account deficits in emerging market countries with exchange rates pegged to the dollar, but not in other emerging market countries. [AA-DD-XX curves for emerging markets under fixed and flexible exchange rates – extended model could be necessary]