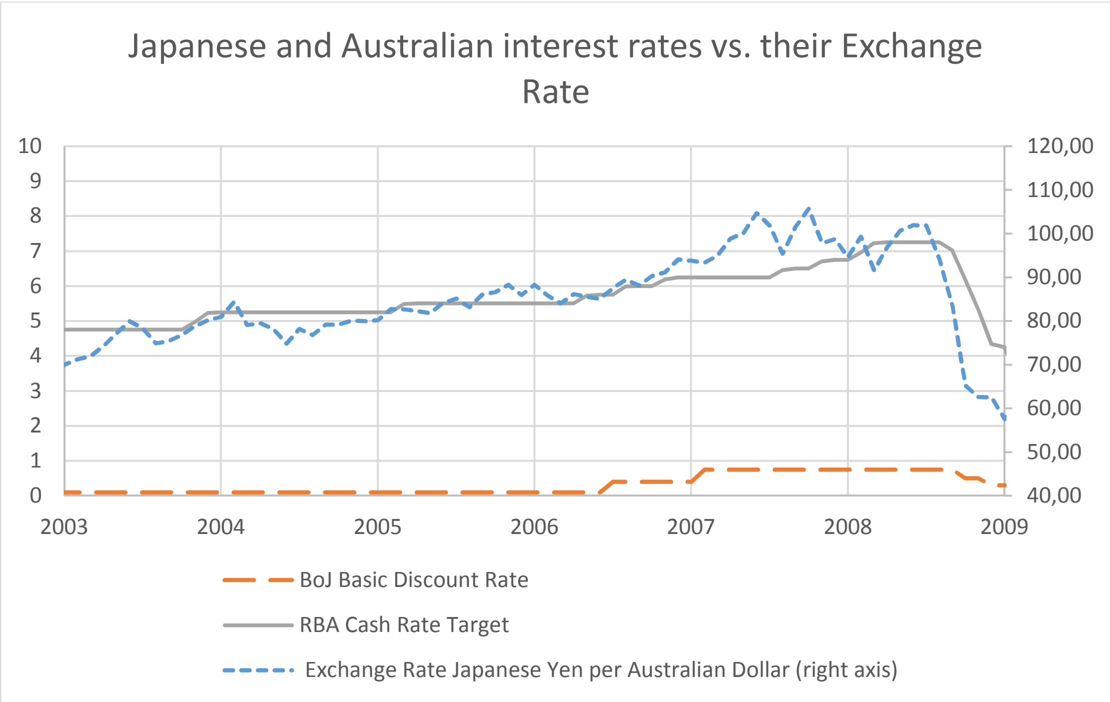
Retake Exam ”International Monetary Economics I”

June 13, 2016

Question 1 (30%)

a) Explain the concept of Uncovered Interest Parity (UIP).

b) Discuss the data displayed in the figure below in the light of UIP.



Question 2 (35%)

Consider a symmetrical two-country world made up of countries A and B. Starting from an initial equilibrium with zero output gaps in both countries, country A experiences a domestic spending boom.

a) How are the world and the two countries individually affected if the exchange rate is flexible and
   i. money supplies are unchanged:
   ii. monetary policies in both countries are adjusted so as to keep output gaps unchanged at zero?

b) How are the world and the two countries individually affected if the exchange rate is fixed and if the central bank of country A can use monetary policy to keep the home output gap unchanged whereas the central bank of country B must conduct the foreign exchange market interventions to maintain the currency peg?

Question 3 (35%)

In his paper “International Coordination” (NBER working Paper 21878, January 2016), Jeffrey Frankel discusses a *locomotive game* and a *currency war game* in which countries can get involved.

a) Explain the logic of these two games and the economic policies at issue in each of them.

b) Answer for each of these games: Is there a case for international policy coordination? Explain.