Retake Exam “International Monetary Economics I”

August 21, 2018

Question 1 (30 %)

Greece and Turkey are two countries that have relied on large-scale capital inflows to sustain domestic demand for a long time. In both cases, foreign lending eventually came to a sudden stop – in 2010 in the case of Greece, in 2018 in the case of Turkey.

a) In which major way do the two episodes differ?

b) How is the difference related to the respective exchange-rate regimes of the two countries, and how do you expect the impact of the sudden stops on the real economy to differ in the two cases?

Question 2 (40%)

The basic short-run model of a small open economy with flexible exchange rates is made up of the following 5 equations:

(1) $y_t = b_0 - b_1 r_t + b_2 q_t + b_3 g_t + b_4 y_t^*$

(2) $m_t - p_t = c_0 + c_1 y_t - c_2 R_t$

(3) $r_t = R_t - (p_{t+1}^e - p_t)$

(4) $q_t = e_t - (p_t - p_t^*)$

(5) $R_t = R_t^* + (e_{t+1}^e - e_t)$

a) Name the endogenous variables that are determined by the model.

b) Compute the effects of a temporary increase in government spending.

c) Compute the effects of a permanent increase in government spending.

d) Illustrate the differences between cases b) and c) in a DD-AA diagram.

Question 3 (30%)

In 1992, the European Monetary System (EMS) underwent a major crisis.

a) Explain the macroeconomic developments that led to the crisis using a symmetric 2-country model.

b) Would the same macroeconomic developments have played out differently if the European Monetary Union had already existed at the time?