

Final Exam “International Monetary Economics I”

February 21, 2018

Question 1

- Name and discuss two criteria for a group of countries to form a currency area. How does the Eurozone perform on these criteria compared to the United States?
- “Countries abandoning the Gold Standard in the wake of the Great Depression started a race of competitive ‘beggar-thy-neighbor’ devaluations that deepened the Depression.”* Discuss.

Question 2

Consider the following model of a stationary small open economy with a flexible exchange rate:

$$\begin{aligned}
 (1) \quad y_t &= b_0 - b_1 r_t + b_2 q_t + b_3 g_t + b_4 y_t^* & (2) \quad m_t - p_t &= c_0 + c_1 y_t - c_2 R_t \\
 (3) \quad r_t &= R_t - (p_{t+1}^e - p_t) & (4) \quad q_t &= e_t - (p_t - p_t^*) \\
 (5) \quad R_t &= R_t^* + (e_{t+1}^e - e_t)
 \end{aligned}$$

- Compute the long-run effects of a permanent increase in the money supply
- Compute the short-run effects of a permanent increase in the money supply.
- Explain the concept of exchange-rate “overshooting” and relate it to your results in a) and b).

Question 3

Consider two countries, North and South, forming a monetary union. Their economies can be described as follows:

$$(1) \quad y_i = -b_1 r + b_3 g_i + b_4 y_j, \quad i, j = N, S; i \neq j$$

- The central bank adjusts the interest rate to keep the output gap of the aggregate monetary union at zero. Derive the central bank’s reaction function which describes how it sets the interest rate.
- How does a decrease in government spending in the South affect the output gap in the North?
- How does your answer in b) change if the ZLB is binding?

[For b) and c), free to use either algebra or a diagram]