SIMON FRASER UNIVERSITY
Department of Economics

Econ 345 | Prof. Kasa
International Finance | Spring 2010

PROBLEM SET 2
(Due March 26)

Questions 1-3. Answer True, False, or Uncertain. Briefly explain your answer. No credit without explanation (10 points each).

1. Countries that peg their exchange rate give up control of their domestic monetary policy.
2. Uncovered Interest Parity does not hold under fixed exchange rates.
3. Devaluations increase domestic output.

   The following questions are short answer. 20 points each.

4. Using the DD-AA model, compare and contrast the relative effectiveness of temporary monetary and fiscal policies under fixed and flexible exchange rates. What accounts for the differences?
5. China is widely suspected of 'sterilizing' its recent purchases of U.S. dollar assets. Explain how you would examine the validity of this claim (e.g., what data would you look at, and how would you use it to decide whether China sterizes its reserve inflows). Why might China want to do this? Are there any costs associated with this policy?
6. Briefly compare and contrast first- and second-generation theories of speculative attacks. For example, how do their assumptions about government policy differ? How would you go about distinguishing these theories empirically? Which provides more support for IMF bailouts?