

SIMON FRASER UNIVERSITY
Department of Economics

Econ 345
International Finance

Prof. Kasa
Fall 2017

PROBLEM SET 2
(Due November 10)

The following questions are short answer. 25 points each.

1. Every so often proposals are made to link Canada's exchange rate more closely to that of the USA. Some people have even called for a common currency, like in Europe. Use the DD-AA model to discuss how this would change the way Canada responds to shocks emanating from the USA. Under what conditions would a fixed exchange rate produce more stability? When would it lead to greater instability?
2. China's central bank recently announced that it was going to target domestic interest rates more closely, mimicking the sort of monetary policies pursued in the USA and Canada. Discuss the implications of this new policy for China's exchange rate and domestic financial markets. (Hint: Read the article by Mankiw posted on the course webpage entitled *The Trilemma of International Finance*). Do you think this policy is a good idea? Why or why not?