SIMON FRASER UNIVERSITY
Department of Economics

Econ 345 | Prof. Kasa
International Finance | Spring 2020

PROBLEM SET 3
(Due April 8)

1. (25 points). Read the article from *The Economist* entitled "It's Been a Privilege", which is posted on the class webpage. According to the article, how does the current importance of the US dollar in the international financial system compare to its importance during the Bretton Woods System immediately following World War II? Explain. Is the current role of the US dollar good or bad for the US economy? Why? According to the article, how might the Trump administration threaten the future position of the US dollar in the international financial system?

2. (25 points). Scientists are currently working hard to develop a vaccine for COVID-19. Economists are also working hard to contain its economic effects. Although our simple DD-AA model is inadequate to capture all of the consequences, it does shed light on some of them. For example, Problem Set 2 asked you to think of the virus from the perspective of the financial markets, as producing an increased demand for liquidity. This question asks you to think about it from the perspective of the goods market. In particular, heightened uncertainty not only leads to a portfolio shift toward safe assets, it also produces an overall increase in saving. (Economists call this 'precautionary saving'). Of course, higher saving means the demand for goods and services decreases. Use the DD-AA model to illustrate the macroeconomic effects of a virus-induced increase in the saving rate. What happens to output, interest rates, and the exchange rate?

   Usually in economics, the consequences of given shock or policy depends on whether it is country-specific or whether it is global (ie, common to all countries). The COVID-19 shock is a *global* shock if there ever was one! How does this affect your analysis of the macroeconomic effects of an increased saving rate? Are the effects on a given country bigger or smaller when all countries simultaneously increase their saving rates? Why? Illustrate your answer with a graph, if possible.