SIMON FRASER UNIVERSITY
Department of Economics

Econ 345   Prof. Kasa
International Finance   Fall 2016

PROBLEM SET 2 - Due November 15

1. (25 points). Suppose you get a job as an economic advisor to the Chinese government.
   The economy has been weakening, and you are asked what should be done. One pro-
   posal is to allow the currency to depreciate against the US dollar (i.e., a 'devaluation').
   Use the DD-AA model to explain why a devaluation might be an effective policy. Can
   you think of a reason why this might be a dangerous policy? (Hint: What happens if
   investors begin to suspect <u>another</u> devaluation in the future? Use the DD-AA model
   to illustrate the effects of an anticipated <u>future</u> devaluation?).

2. (25 points). Suppose Hillary Clinton gets elected, and that Donald Trump was right
   - the U.S. embarks on a program of increased government spending and increased
   government deficits. Given that China has a 'fixed' exchange rate with the US dollar,
   use the DD-AA model to analyze the likely consequences for China. Would the Clinton
   election be good news or bad news for the Chinese economy?