## SIMON FRASER UNIVERSITY Department of Economics

Econ 345 International Finance Prof. Kasa Fall 2004

## FINAL EXAM

Questions 1-7. Answer True, False, or Uncertain. Briefly explain your answer. No credit without explanation (5 points each).

- 1. If a country has a fixed exchange rate, it can no longer use monetary policy to influence domestic output.
- 2. If a country has a fixed exchange rate, it can no longer use monetary policy to influence domestic inflation.
- 3. The DD-AA/Mundell-Fleming model predicts that when the U.S. lowers interest rates, output in Canada declines.
- 4. According to the DD-AA/Mundell-Fleming model, fiscal policy is ineffective under flexible exchange rates.
- 5. According to the DD-AA/Mundell-Fleming model, monetary expansions (i.e., money supply increases or interest rate decreases) tend to produce current account deficits.
- 6. If Purchasing Power Parity holds then inflation rates must be equal across countries.
- 7. A devaluation causes the central bank to lose foreign exchange reserves.

The following questions are short answer.

- 8. (20 points).
  - (a) Suppose an economy experiences a temporary decline in the demand for its exports. Use the DD-AA model to compare and contrast the economy's response under fixed and flexible exchange rates.
  - (b) Now suppose there is a temporary increase in money demand. Again compare and contrast how the economy responds under fixed and flexible exchange rates.
  - (c) Use your answers to parts (a) and (b) to draw conclusions about whether fixed or flexible exchange rate systems are more effective at stabilizing the level of output.
- 9. (15 points). Recently there has been a lot of debate within Europe and Japan about the need to support the U.S. dollar. We know from class that the U.S. could raise the value of the dollar either by contractionary monetary policy (i.e., a reduced money supply) or by expansionary fiscal policy (i.e., an increase in government spending). Which option do you think Europe and Japan would prefer? Why?

- 10. (15 points). Briefly discuss the contrasting policy implications of first- and second-generation currency crisis theories. Which is more supportive of IMF-style "rescue packages"?
- 11. (15 points). Using Mundell's Optimum Currency Area criteria, explain why countries that are geographically close to each other are likely to be better candidates for a Monetary Union. (Hint: How does geographic proximity affect the GG and LL curves?).