1. (2 points) Explain the effect of temporary monetary expansion on output under a flexible exchange rate, using the AA-DD framework. Compare that with the effect of the same policy under fixed exchange rate. Is the effect on output different across exchange rate systems? Why? How will your answer change when the monetary expansion is permanent?

2. (2 points) Explain the effect of temporary fiscal expansion on output under a flexible exchange rate, using the AA-DD framework. Compare that with the effect of the same policy under fixed exchange rate. Is the effect on output different across exchange rate systems? Why? How will your answer change when the fiscal expansion is permanent?

3. (2 points) Describe the effects of an unexpected devaluation of a currency on the central bank’s balance sheet, output and the balance of payments account.

4. (2 points) What causes a balance of payments crisis? Are speculative attacks on a national currency or capital flights irrational? Write a time path of domestic bonds, foreign reserves, money supply and interest rate before and after a crisis.

5. (2 points) In a three-country world, a central bank fixes one exchange rate but lets the other float. Can it use monetary policy to affect output? Can it fix both exchange rates?