1. (2 points) Use the FX market diagram to demonstrate the effects of the following events on the dollar-peso exchange rates. Display the time path of exchange rates too.
   a. The Bank of Mexico (i.e. Mexico’s central bank) sells Mexico’s government bonds and then buys the bonds from commercial banks 2 months later.
   b. Market participants expect the Bank of Mexico to sell Mexico’s government bonds next month and the sale is expected to last for 2 months.

2. (6 points) Assume that prices in goods markets are sticky in the short run, but prices in asset markets are fully flexible. Use the FX diagram and the money market diagram to explain the short-run and long-run movements in dollar-peso exchange rates. Display the time path of exchange rate, price level and nominal interest rate. Is there exchange rate overshooting in each case?
   a. The Bank of Mexico reduces money supply permanently.
   b. Output in Mexico rises permanently.
   c. Both (a) and (b) occur at the same time. Assume that the rate of change of money supply and that of output are the same.

3. (2 points) Hong Kong fixes its exchange rate with the US dollar. How does this exchange rate policy influence interest rate and inflation in Hong Kong? Explain using the Trilemma.