Econ 371: Problem Set 3 (Chapter 15)

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Due date: March 3, 2005

Instruction: Answer whether the following statements are true or false. When you think it is true, write “T” in front of the question. Write “F” otherwise. (1 point each)

1. The relative purchasing power parity states that exchange rate depreciation must be the same as expected inflation differentials.

2. The Fischer effect implies that a rise in the expectation of the U.S. inflation rate will raise the real interest rate on dollar deposits.

3. The absolute purchasing power parity assumes that real exchange rate is unity.

4. The monetary approach of long run exchange rate determination predicts that the time path of exchange rate is the same as that of domestic inflation.

5. The monetary approach completely ignores the role of goods market in long run exchange rate determination.

6. According to the monetary approach, a permanent rise in nominal interest rate causes exchange rate to appreciate.

7. Balassa-Samuelson theory implies that a country’s currency will experience real exchange rate appreciation when its economic growth is biased towards traded sector.

8. According to the general theory of long run exchange rate determination, real exchange rate depends on nominal exchange rate.

9. According to the general theory of long run exchange rate determination, nominal exchange rate depends on real exchange rate.

10. According to the general theory of long run exchange rate determination, a permanent rise in nominal interest rate causes exchange rate to appreciate.