1. (2 points) Explain the effect of permanent fiscal expansion on output under a fixed exchange rate. Compare that with the effect of the same policy under floating in Chapter 16. Are they the same? Why?

2. (2 points) Explain the effect of permanent monetary contraction on output under a fixed exchange rate. Compare that with the effect of the same policy under floating in Chapter 16. Are they the same? Why?

3. (2 points) What causes a currency crisis? Write down a time path of inflation and interest rate before and after a currency crisis, as predicted by the model of a currency crisis discussed in class.

4. (2 points) In Figure 3 in the class note on Argentina’s currency crisis, peso interest rate rises dramatically shortly before and after the crisis. The interest rate hike before a crisis contradicts the prediction based on the model discussed in class. Can you think of reasons why actual interest rate behaves differently from the theory? How is it related to capital flight?

5. (2 points) The U.S. foreign exchange intervention is sometimes done by an Exchange Stabilization Fund or ESF (a branch of the Treasury Department) that manages a portfolio of U.S. government and foreign currency bonds. An ESF intervention to support the yen, for example, would take the form of a portfolio shift out of dollar and into yen assets. Show that ESF intervention are automatically sterilized and thus do not alter money supplies. How do ESF operations affect the foreign exchange risk premium?