1. (2 points) Suppose the U.S. economy falls into a recession. Will you recommend a permanent money expansion or a temporary money expansion to the Fed? Why? Explain using an appropriate diagrams.

2. (2 points) How will your answer in Question 1 change if the Fed fixes the dollar-euro exchange rate? What policy will you recommend policy-makers in Washington? Why?

3. (2 points) In recent years there have been speculations about a revaluation of the Chinese Yuan, which is currently fixed against the U.S. dollar. Explain the effect of the speculations on the central bank’s balance sheet and inflation in China.

4. (2 points) What causes a currency crisis? Write down a time path of inflation and money supply before and after a currency crisis, as predicted by the model of currency crises.

5. (2 points) In practice, we observe dramatic increases in interest rate before a currency crisis. Can you give a reason for the interest rate hikes? How are they related to capital flight?