Econ 371 Spring 2006
Problem Set 5 (Chapter 17-18)

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Due date: April 17, 2005

Part 1: 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. (0.5 point each)

1. A central bank can change interest rate without changing money supply by using sterilized interventions.
2. In theory, the gold exchange standard has the price-specie-flow mechanism and does not have the N-1 problem.
3. With the gold standard, a discovery of new gold supply causes gold price to fall and then creates inflation.
4. President Nixon shut down gold-dollar exchanges in 1971 in order to sustain the value of gold.
5. The optimal external balance is achieved when current account is balanced.
6. The optimal internal balance is full employment.
7. For a small economy, external balance is more important than internal balance, because its output is heavily influenced by demand from other economies.
8. With fixed exchange rate, fiscal policy cannot achieve both internal and external balance.
Part 2: Answer the following questions. Illustrate a diagram as requested. (2 points each)

1. Thai baht has recently appreciated against the U.S. dollar. Many Thai exporters fear that they will lose competitiveness, and suggest interventions in foreign exchange markets. Explain how the Bank of Thailand can prevent the baht from appreciating using sterilized interventions. What are the impacts on money supply and inflation?

2. How is the price-specie-flow mechanism related to the Great Depression?

3. The U.S. external balance continues to be worsened over the past few years. Which policy is more effective in bringing the U.S. economy to external balance, expenditure-changing policy or expenditure-switching policy? Why?