Part One

Mark your test form as "A." Answer whether the following statements are true or false. If you answer true, mark "A" in the answer sheet. Mark "B" otherwise. Note that you must use pencil no. 2 to answer questions in Part One. (30 questions with 1 point each)

1. Current account balance measures the difference between total output and total use of goods and services of an open economy.

2. When current account is in deficit, balance of payments runs a deficit too.

3. The large U.S. current account deficit is not a problem, since the U.S. borrows in the U.S. dollar.

4. The interest rate parity implies free capital mobility.

5. The interest rate parity predicts that the dollar will appreciate when the Fed raises interest rate.

6. The interest rate parity predicts that the dollar will appreciate when the Fed is expected to raise interest rate.

7. An increase in real output in the U.S. makes the dollar depreciate, all else equal.

8. The Fed can influence the dollar-euro exchange rate by using its monetary policy, even when price is not sticky in the short run.

9. With short-run price stickiness, a permanent money reduction causes exchange rate to overshoot.

10. With short-run price stickiness, a temporary money expansion causes exchange rate to undershoot.

11. The law of one price holds for both traded goods and non-traded goods.

12. Brazil’s central bank tends to let its money supply grow at a faster rate than the Fed. According to the purchasing power parity, we would predict that the Brazilian Real will depreciate relative to the U.S. dollar over time.

13. China’s exporting sector has experienced high productivity growth for over a decade. The Balassa-Samuelson hypothesis predicts that the Chinese Yuan will appreciate if China removes foreign exchange controls.

14. China’s exporting sector has experienced high productivity growth for over a decade. The general theory predicts that the Chinese Yuan will appreciate if China removes foreign exchange controls.
15. A permanent tax cut causes exchange rate appreciation and output expansion.

16. A temporary tax cut causes exchange rate appreciation and output expansion.

17. Under fixed exchange rate regime, a temporary tax cut decreases foreign exchange reserves.

18. Under fixed exchange rate regime, a temporary money expansion increases foreign exchange reserves.

19. Under fixed exchange rate regime, export growth increases foreign exchange reserves.

20. In theory, a currency crisis does not take place in a low-inflation economy.

21. Foreign exchange controls can prevent a currency crisis.

22. Sterilized interventions can prevent a currency crisis.

23. When sterilized interventions involve a reduction in foreign assets, the risk premium on the domestic bonds rises.

24. A central bank can appreciate its currency by engaging in sterilized interventions which reduce foreign assets.

25. Countries cannot reach their external balance in the long run without exchange rate adjustment.


27. The price-specie-flow mechanism suggests that gold inflows reduce the price level because it raises the supply of gold.

28. The price-specie-flow mechanism also exists under the gold exchange standard.

29. The Bretton Woods System broke down because of global imbalance created by the N-1 problem.

30. The choice between fixed and flexible exchange rate arrangement is a monetary question. It has nothing to do with what is going on in goods and labor markets.
Part Two

Answer the following questions. Depict appropriate diagrams as required. (6 questions with 10 points each)

1. Currently the U.S. current account deficit is about 7 percent of GDP, and the US fiscal deficit is projected to be 4.5 percent of GDP this year. Moreover, the Iraq war expense is rising. Given the situation, many economists have voiced concerns about a potential balance-of-payments crisis. What are the rationale for the concerns? Explain using the theory of balance-of-payments crisis. What would be consequences of a currency crisis on the U.S. economy?

2. Explain the effects of a permanent tax cut on output and current account in the short run under fixed exchange rate system. Compare that with the case with flexible exchange rate system. Which case has a larger effect on output? Depict an appropriate diagram.

3. Explain the price-specie-flow mechanism under the international gold standard. How is it related to the Great Depression?

4. Under the Bretton Woods system, the world was actually a single currency area in which the U.S. dollar was the world currency. However, the world could not function as an optimum currency area and the system broke down in 1973. Discuss policy changes that could make the world become an optimum currency area.

5. Suppose there are 3 stock markets in the world. One is in New York, one is in Chicago, and the last one is in Tokyo. If you can invest in only two markets, which two out of the three markets would you choose? Why?

6. Suppose the public telephone company in Brazil wants to invest in new wireless technology which costs 1 billion U.S. dollars. With probability 3/4, the project will create 1.2 billion U.S. dollars of revenue. However, the project may fail and pay nothing with probability 1/4. Will the project get funded by an international bank without a Brazilian government guarantee? Will a 50-percent guarantee from the Brazilian government create moral hazard?