Public Affairs 854
Fall 2016
University of Wisconsin-Madison

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Social Sciences 7418

Problem Set 3 (rev'd)

Due in Lecture on Monday, October 31st.

1. Consider the Mundell-Fleming model, under fixed exchange rates, and high capital mobility.
   1.1. Show graphically what happens if the foreign interest (considered exogenous) rises, immediately.
   1.2. Assume sterilization; what happens to output, interest rates, real exchange rate, and foreign exchange reserves. Show graphically what happens.
   1.3. Show what policies are available to the policy authorities if they wish to avoid foreign exchange decumulation.
   1.4. Instead of a foreign interest rate increase, suppose exports autonomously decline. Show what happens immediately.
2. Consider the Mundell-Fleming model, under floating exchange rates, and high capital mobility.
   2.1. Show graphically what happens if the foreign interest (considered exogenous) rises, immediately.
   2.2. Assume sterilization; what happens to output, interest rates, real exchange rate, and foreign exchange reserves. Show graphically what happens.
   2.3. Show what policies are available to the policy authorities if they wish to avoid an exchange rate change.
   2.4. Instead of a foreign interest rate increase, suppose exports autonomously decline. Show what happens immediately.
3. ~~Consider an AD-AS model. Show what happens if~~ $\cancel{\overline{FA}}$ ~~exogenously declines, so the real exchange rate depreciates. Also,~~ $\cancel{Z > 0}$ ~~for one period as all imported goods rise in price. Assume expected inflation is zero.~~
   ~~3.1 Show graphically what happens in the AD-AS graph.~~
   ~~3.2 Suppose the policy authorities didn't want the price level to rise. What policies could they implement?~~

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