Matr.-Nr. _____   Name: _____

Examination	**International Macroeconomics and Finance (No. 1293)**
Examiners:	**Prof. Dr. Dr. h.c. Gerhard Schwödiauer/ PD Dr. Ludwig von Auer**
Semester:	**Winter Semester 2005/06**
The following aids may be used:	**Non-programmable pocket calculators; English language dictionaries without any marking.**
Time:	**120 minutes**

This exam comprises <u>25 problems</u>. For each problem <u>exactly one</u> of the <u>three optional answers</u> is correct. Do not mark more than one answer to any of the questions, otherwise the solution will be considered false. For every correct answer you obtain 2 points, for every false answer 1 point is subtracted. If no answer is marked you neither obtain nor lose a point.

Make sure that this copy of the exam bears your <u>matriculation number</u> and <u>name</u> in the appropriate fields at the top of this page!

Examination Questions:

1. In period t an effective depreciation of the euro is recorded if, other things being equal,

    ☐ a)   the share of a major trading partner of the euro-area in the euro-area's foreign trade, whose currency has not depreciated via-a-vis the euro, has increased in the current period;

    ☐ b)   the euro has depreciated in terms of the currencies of some trading partners while not appreciating against the others;

    ☐ c)   the price level of the euro-area's exports has decreased relative to the price levels in the rest of the world.

2. The real exchange rate of some country is said to fall if

    ☐ a)   for unchanged nominal exchange rates, its inflation rate over the last year has been higher than the inflation rate in the rest of the world;

    ☐ b)   for unchanged nominal exchange rates, its inflation rate has been lower than the other countries' inflation rates;

    ☐ c)   the country's terms of trade have improved over the last year.

3. If the spot exchange rate of the euro is 1.20 $ and the 12-month forward rate is 1.25 $ and the interest rate of 12-month euro deposits is 3 %, the CIP condition requires the interest rate on 12-month dollar deposits to be (approximately)

- [ ] a) 10 %;
- [ ] b) 7 %;
- [ ] c) 5 %.

4. The Relative Purchasing Power Parity hypothesis claims that

- [ ] a) the real exchange rate between two currencies is constant.
- [ ] b) in the medium run the two currencies' purchasing power is the same.
- [ ] c) in the medium run monetary policies do not affect the real exchange rate between two currencies.

5. Assume that there are strict capital controls but full convertibility for current-account transactions. In the short run (for given GDP) and without central bank intervention, an equilibrium of the foreign exchange market is stable with respect to small shocks if

- [ ] a) the sum of export and import exchange-rate elasticities is smaller than 1.
- [ ] b) the sum of export and import elasticities is equal to 1.
- [ ] c) the sum of import and export elasticities is bigger than 1.

6. Assume that the value of a country's exports is 20 billion, and there is a trade deficit of 20 billion. The price elasticity of exports is $^3/_4$, that of imports $^1/_2$. A devaluation of the domestic currency will

- [ ] a) improve the trade balance (measured in domestic currency).
- [ ] b) worsen the trade balance (measured in domestic currency).
- [ ] c) worsen the trade balance (measured in foreign currency).

7. In the German balance-of-payments accounts (where exports are credits, and imports debits), the purchase of a controlling stake in a US company by a German firm for dollars in cash affects

- [ ] a) the unilateral-transfers account on the debit and the short-term capital account on the credit side.
- [ ] b) the long-term capital account on the debit and the short-term capital account on the credit side.
- [ ] c) the short-term capital account on the debit and the long-term capital account on the credit side.

8. In the German balance-of-payments accounts the German annual contribution to the EU budget affects

- [ ] a) the unilateral-transfers account on the debit and the ORT account on the credit side.
- [ ] b) the unilateral-transfers account on the debit and the short-term capital account on the credit side.
- [ ] c) the short-term capital account on the credit side and the ORT account on the debit side.

9. If an economy's national saving is bigger than aggregate investment, the country's balance of payments shows

- [ ] a) a deficit on the capital account or ORT account.
- [ ] b) a surplus on the capital account and ORT account.
- [ ] c) a deficit on the current account.

10. Assume that the marginal propensity to consume for a small economy is 0.4, the marginal propensity to invest is 0.3, the marginal propensity to import is 1.0, and the marginal tax rate on incomes is 0.5. At a given rate of interest an increase in government consumption by 12 billion will increase domestic effective demand (GDP) by

- [ ] a) 8 billion.
- [ ] b) 12 billion.
- [ ] c) 15 billion.

11. Assume that the economy in problem 10 would be large enough so that a change in its GDP would have a significant effect on the rest of the world. Would in this case the impact of the increase in real exports on domestic GDP be

- [ ] a) bigger than
- [ ] b) small than
- [ ] c) the same as

for the small economy?

12. Consider a small economy with internationally fully integrated capital markets. Suppose that the government wishes to minimize the fluctuations of domestic real GDP in the presence of fluctuating domestic investment and volatile foreign demand for domestic output. Which exchange rate regime would be preferable if the volatility of investment is much higher than that of foreign demand?

- [ ] a) Fixed exchange rates.
- [ ] b) Floating exchange rates.
- [ ] c) Does not matter.

13. The Laursen-Metzler-Harberger (LMH) effect claims that current aggregate domestic consumption increases when there is

   ☐ a) a real appreciation of the domestic currency that is expected to be just temporary.
   ☐ b) a real depreciation of the domestic currency that is expected to be just temporary.
   ☐ c) a real depreciation of the domestic currency that is expected to be permanent.

14. In the presence of the LMH-effect, the impact of a fiscal stimulus on effective aggregate demand in a small open economy with a floating exchange rate and perfect international capital mobility is

   ☐ a) bigger than
   ☐ b) small than
   ☐ c) the same as

   without the LMH-effect?

15. Assume that for a given exchange rate and a given level of public expenditure a small open economy suffers from a trade balance deficit and an underemployment level of GDP. In order to restore full employment and a zero trade balance, an appropriate policy mix (if the ML-condition holds) may be

   ☐ a) a devaluation of the domestic currency and a cut in government expenditure.
   ☐ b) a revaluation of the domestic currency and an increase in government expenditure.
   ☐ c) an increase in government expenditure without a change in the exchange rate.

16. Under a regime of fixed exchange rates and without sterilization by the central bank, the contractionary effect of a rise in government taxes is

   ☐ a) higher for low than for high capital mobility.
   ☐ b) higher for high than for low capital mobility.
   ☐ c) independent on the degree of capital mobility.

17. Consider a small open economy under conditions of perfect international capital mobility and floating exchange rates. The effect of an expansionary monetary policy on effective aggregate demand

   ☐ a) is enhanced by extrapolative expectations about the rate of appreciation of the foreign currency.
   ☐ b) is enhanced by regressive expectations about the rate of appreciation of the foreign currency.
   ☐ c) is independent of the type of exchange rate expectations.

18. A fall in the foreign rate of interest has, if there is some capital mobility,

- [ ] a) an expansionary effect on domestic aggregate demand if the exchange rate is freely floating.
- [ ] b) an expansionary effect on domestic aggregate demand if the exchange rate is kept fixed.
- [ ] c) a contractionary effect on domestic aggregate demand under any exchange rate regime.

19. For a small open economy, which imports semi-finished goods, an appreciation of its currency will have

- [ ] a) a contracting effect on short-run aggregate supply (SAS).
- [ ] b) an expansionary effect on SAS.
- [ ] c) no impact on SAS.

20. According to the Dornbusch model, an unanticipated, once-and-for-all increase in the domestic money supply will

- [ ] a) in the longer run cause a fall in the domestic real exchange rate.
- [ ] b) immediately have no effect on the domestic real exchange rate.
- [ ] c) immediately cause the real exchange rate of the domestic currency to fall.

21. Under conditions of high capital mobility, the effect of a cut in taxes on domestic effective demand

- [ ] a) is stronger if the monetary authorities keep the exchange rate fixed than for a floating exchange rate.
- [ ] b) is stronger if the exchange rate is freely floating than in the case of a fixed exchange rate.
- [ ] c) does not depend on the exchange rate policy rule.

22. Assume that a small member country of the European Monetary Union experiences a domestic investment recession. As a consequence, without any policy response, the decrease of effective aggregate demand

- [ ] a) is smaller than it would be if the country were not member of EMU and let its exchange rate float.
- [ ] b) is bigger than it would be in the case of non-membership in EMU and floating exchange rate.
- [ ] c) does not depend on the country being member of EMU or not.

23. The Dornbusch model predicts that an unanticipated permanent increase in the foreign interest rate will lead to an immediate increase in the price of foreign currency

- [ ] a) which is below its medium-run appreciation if the interest elasticity of money demand is low.
- [ ] b) which is above its medium-run appreciation, and is the higher the lower is the interest elasticity of money demand.
- [ ] c) equal to its medium-run appreciation.

24. Under a regime of floating exchange rates, a reduction in the domestic government's budget deficit will bring about

- [ ] a) an appreciation of the domestic currency.
- [ ] b) an appreciation of the domestic currency for very low capital mobility.
- [ ] c) an appreciation of the domestic currency for sufficiently high capital mobility.

25. The Dornbusch model predicts, in consequence of a monetary contraction, for the medium run an appreciation of the domestic currency which is

- [ ] a) higher than predicted by the relative purchasing power parity (RPPP) hypothesis.
- [ ] b) lower than predicted by RPPP.
- [ ] c) equal to the RPPP prediction.

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