Note: given the fact that you’re ‘obliged’ to answer the weekly questions, try to profit the most from the task:

- Start by reading the lecture notes.

- Looking at them as little as possible, answer the questions.

Reserve **3 hours** for this homework.

The answers of the questions of **week 8** should be handed to me at the beginning of **Wednesday’s lecture of Nov 16th.** They should be **manuscript (not typewritten)**, **concise** and preferably based on schemes (as I do in the whiteboard). Keep a copy for yourself.

Please write **WEEK 8 in bold** at the beginning of your answers.

**WEEK 8**

**Ch. 2: Fixed exchange rates**

**L15: The effects on U, the TB and the Budget balance of a decline in DD (review)**

**1.** Consider an economy that, after being hit by a decline in DD, finds itself with U and a trade surplus.

a) Can the government use fiscal policy to move the economy back to full-employment? Explain.

b) Why may the government be instead forced to use restrictive fiscal policy in the aftermath of a decline in domestic demand?

c) What can you conclude about the effect of a decline in domestic demand on a country with fixed rates?

**2.** a) What’s the effect of an increase in government spending on the TB? Explain.

b) How can a trade deficit be funded?

c) After a few years of successive TDs how will foreign banks react? Explain.

**3.** a) After a few years of successive TDs what will IFI start expecting about the $ reserves of the CB and the value of the Peso? Explain.

b) What will they then about financial capital movements? Explain.

c) When will depreciation take place? Explain.

**L16: The effects on U and the TB of a decline in NX**

**4.**What does short-selling a currency mean?

**5.** a) Under which circumstances, will investors short-sell a currency?

b) Short-selling may lead to either big gains or to big losses. Do you agree? Explain.

**6.** Give three historical examples of countries hit by declines in external demand.

**7.** Consider a country in fixed rates, initially at FE and with an equilibrium in the TB, that suffers a sharp decline in its exports. Explain the two resulting disequilibria. Illustrate in the two graphs presented in the lecture.

**8.** What happens if the country remains in the new position for some years?

This an exam-like question, and requires a long answer.

**9.** Knowing that, IFI and speculators will start believing that the government will soon decide between two sorts of the adjustment. Which ones? Explain in detailed way

**10.** “The advantage of an adjustment through a depreciation relative to an adjustment through austerity is bigger, the bigger the magnitude of the decline in exports”. Do you agree? Explain.