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 **4 hours** for this homework.

The answers to the following questions should be handed to me at the beginning of **Wednesday’s lecture of Nov 30th.** 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 10 in bold** at the beginning of your answers.

**WEEK 10**

**Part II of the syllabus: Open ec. MACROECONOMICS**

**L20: Capital flights in fixed exchange rates**

**The speculative attack against the $HK**

**1.** Explain the two reasons why a decrease in interest rates boosts firms’ profits.

**2.** Explain the four reasons why a decrease in interest rates tends to bring about a rise in stock prices.

**3. a)** Why did the $HK appreciate against the yen in 1996-2000?

b) Why did two types of HK’s X fell in 1997-8?

**4.** What was the difference in the manner speculation against the $HK in 1998 and speculation against the £ in 1992 were done?

**3.** Speculators against the $HK would gain if this ended up depreciating. Why?

**4.** a) How did speculators expect the CB of HK would defend the $HK?

b) What would happen to them in that case? Explain.

**5.** How did the CB of HK prevent the $HK from depreciating?

**6.** How did that, along with a measure enacted by the $HK, cause losses for speculators?

**The capital flight from the US near the end of the Bretton Woods system of fixed exchange rates**

**7.** What were the two main expenditures associated with the US fiscal expansion after 1995?

**8.** What were the consequences of that fiscal expansion on the:

**a)** Trade balance? Explain.

**b)** Private consumption and investment? Explain.

**c)** Inflation? Explain.

**9.** Explain the two channels through which the increase in the US domestic demand eventually led to an increase in European inflation.

**10.** If the appreciation of the DM against the dollar had occurred in 1968, German inflation would not have increased from 2% to 6% in 1972. Explain the two reasons for this.

**11.** An appreciation of the DM would have prevented the US fiscal expansion from causing an increase in inflation in Germany. How did that idea affect the behaviour of the IFIs and speculators?

**12.** With the end of the BWoods system in Aug 1971, which of the two - IFI or speculators – ended up gaining? What happened to the one that did not gain? Explain.

**L21: Hedge Funds and the near failure of LTMC in 1998**

**13**.Why is the interest rate on US corporate bonds so important?

**14.** Why is the price of a bond inversely related with its interest rate?

**15.** a) How does a mutual fund raise money?

b) Where does a mutual fund apply its money?

c) Why do many people prefer to buy shares from mutual funds rather than buy individual stocks and bonds?

**16.** How does an hedge fund raise money?

**17.** a) Explain the way the LTMC – when it was created - raised money and where this was applied in.

b) How was the buffer calculated?

c) Why did Jp banks demanded a buffer?

**18.** The LTMC funded most of its securities purchases with borrowed money.

a) Why did that imply a big risk?

b) Why did that created the possibility of amplified gains?

**19.** How was the LTMC capable of expanding its acquired securities from $100b to $500b in a time-span of just four years?

**20.** Why did the Russian currency eventually suffered a sharp depreciation?

**21.** a) What was the **first** consequence of the ruble’s depreciation on the balance-sheet of the LTMC? Explain.

b) How did Jp banks react to that? Explain.

c) Show the **first** consequence of that reaction on the LTMC’s balance-sheet.

d) Show the **subsequent** consequence on the LTMC’s balance-sheet. Explain.

**22.** a) Why could this latter consequence have triggered a downward spiral? Explain that spiral.

b) What would have been the consequences of that spiral on the LTMC? Explain.

c) What would have been the consequences of that spiral on the US economy? Explain.

**23.** How was that spiral averted?