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 Dec 7th.** 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 11 in bold** at the beginning of your answers.

**WEEK 11**

**L22: FLEXIBLE exchange rates**

**I.The effect of a decline in next exports (starting from E0)**

**12.**What is the foreign exchange market?

**13.** a) If the country’s economic agents don´t have access to loans from foreign banks why can’t there be a trade deficit?

b) What’s the consequence of a trade deficit on the exchange rate if the country’s economic agents don´t have access to loans from foreign banks? Explain.

**14.** In that case, what is the effect of a decline in net exports on the country’s economy? Explain, starting from ‘full-equilibrium’.

**15.**  Leave aside IFI and speculators for the moment.

**a)**  What’s the consequence of a trade deficit on the exchange rate if the country’s economic agents can fund it with loans from foreign banks? Explain.

**b)** In that case, what is the effect of a decline in net exports on the country’s economy? Explain, starting from ‘full-equilibrium’.

**c)** What will eventually happen if the country remains in the new position for some years?

**16.a)** How may IFI and speculators react when the successive trade deficits (generated by a decline in net exports) keep on being funded with loans from foreign banks? Explain.

**b)** In that case,what is the effect of a decline in net exports on the country’s economy? Explain, starting from ‘full-equilibrium’.

**17.** Compare the responses of a country in fixed rates and of a country in flexible rates to a decline in net exports. Which of the two is better? Long answer: one full-page.

**II.The effect of a decline in domestic demand (starting from E0)**

**18.** What is the effect of a decline in domestic demand on the value of the domestic currency? Explain.

**19.** Why may a decline in domestic demand may be followed by a decline in exports?

**20.** Why does an interest rate cut by the CB tend to lead to a depreciation of the currency?

**21.** Why does an interest rate cut by the CB tend to lead to an increase in both domestic and external demand?

**L23: The SE-Asian crisis of 1997-8**

1. **Boom**

**22.** a) How was Thail’s construction boom financed?

b) What was its effect on consumption? And on the trade balance and output? Explain.

**23.** What was the effect of Thail’s trade deficit on the dollar reserves of the CB? Explain.

**24.** Explain why an increase in consumption in one period contributes to a new increase in consumption in the following period.

**25.** Explain why an increase in investment in one period contributes to a new increase in investment in the following period.

1. **Crash**

**26.**Why did Thail’s X fall in 1996?

27. What was the effect of that on the construction sector? Explain.

28. What was the effect of the defaults by construction companies on the $ reserves of the CB? Explain.

29. How did IFI and speculators react?

30. a) What was the first reaction of the CB to the behavior of IFI and speculators?

b) Why does a CB interest rate hike tends to contain a capital flight by IFI?

c) Why does a CB interest rate hike tends to contain speculation against the country’s currency?

31. What was the reaction of the CB on July 2nd to the behavior of IFI and speculators?

1. **The effects of depreciation and increases in interest rates**

32. Explain the three channels through which a depreciation has a negative effect on GDP in the **short-term**.

33. What is the effect of a depreciation on the value of imports (P\*Q) in the **short –term**? Explain.

34. Explain the three channels through which an increase in interest rates has a negative effect on GDP.

35. What happened to Thail’s GDP and TB between 1996 and 1997-8? Explain.