

Final challenge: Review
Eco 403, spring 2012

The following questions are taken from past challenges. The format is 4-5 short answer and 2-3 longer questions. The formulas provided below will also be provided on the challenge. All questions come from the notes. Also review chapters BM:4.3-4.4,11.3,12,14.5-14.7, DC:p494-512,18 the third homework and this review sheet.

The quiz is Monday May 7 from 2 pm to 4:30 pm

Monetary Misperceptions

$$U = NR + k \cdot a (\pi_t^e - \pi_t), \quad AS = Y = Y^* + a(P - P^e)$$

Foreign Exchange and Reserves

$$F_t = F_{t-1} + E \cdot \Delta H, \quad e = \frac{P \cdot E}{P^f}$$

Money Supply

$$M = Hk(R) \quad \Delta M = \Delta Hk(R)$$

Evaluation of Inflation Targets

$$\Delta M + \Delta V = \pi + \Delta Y$$

Currency Boards, Gold Standard

$$rrH = \frac{F}{E}, \quad rrH = P_G G$$

Short answer questions (1-2 sentences)

Question 1

Is the inflation rate under a nominal exchange rate target predictable? Explain.

Question 2

In 1999, the Bank of Canada published an inflation target of 1-3%. The money supply growth for 1999 was 7.7%, and real GDP grew at a 4.5% rate. Assuming velocity was constant, according to the quantity theory, was the money growth consistent with the inflation target? Explain.

Longer Questions

Question 3

In the 1800's the U.S. had a currency board tied to gold (a gold standard). During the gold rush of the 1800s, miners exchanged much of their gold at the currency board. Assume the Lucas monetary misperceptions model.

- a. Assuming no other change in policy, explain what happens to the money supply, inflation, unemployment, and the price of gold in the short run.
- b. Graphically illustrate the effect on inflation and unemployment in the short and long run on the Phillips curve graph.

Question 4

In 2001, Argentina had a currency board where 1 Argentina Peso could be exchanged for \$1 or the reverse at the Central Bank of Argentina (CB). The CB maintained a reserve ratio of one and had reserves of about \$27 Million. Argentina then began paying government workers with "coupons". Coupons are notes which promise to pay the owner a specified amount of Pesos in the future. The coupons are in small denominations, may be traded freely, and have been declared legal tender.

- a. Calculate the high powered money in Argentina.
- b. What is the most likely reason the government issued coupons?
- c. Now suppose the coupons are due and the households bring the coupons to the Central Bank to exchange for pesos. List all options which allow the Central Bank pay the coupon holders. Which option(s) require abandoning the currency board?

d. Prior to the coupons becoming due, a speculative attack occurred. Which option in part (c) were the speculators anticipating?