INTERNATIONAL ECONOMICS
HOMEWORK 7
10/01/2014

1. Consider the monetary model of the exchange rate. Suppose there is an unanticipated, one-time increase in the supply of money.

a. What are the effects of this monetary shock on the exchange rate, the interest rate, and the price level in the short and in the long run? Expalin by means of a diagram.

b. Analyze the time from short to long run under the assumption that prices are slow to adjust. By illustrating in a diagram, explain why the exchange rate overshoots and derive time paths for the above variables.

c. Suppose the foreign central bank expands foreign money supply at the same time. Analyze the effects of such a joint monetary expansion.

2. Explain the concept of uncovered interest parity. Consider investing in $US or Euro denominated bonds. Relate your investment decision to your expected future exchange rate. Do you see any connection with the forward rate?