Economics 1102-33
Homework 6
Due date: April 23
(Total = 100 points)

All answers need to be typed except calculations and graphs.
<u>Show all your work for full credit.</u>
Graphs need to be correctly labeled for full credit.
No late Assignments are accepted

1. For each of the following cases, show (on a relevant graph) what would happen to the value of the U.S. dollar (in relation to the Japanese yen) after the given action occurs (assuming a floating exchange rate system). **State** if the US dollar appreciates or depreciates relative to the yen in each case.
Note: Draw a graph with quantity of dollars in the x-axis and the price of dollars (in terms of yen in the y-axis)

a) U.S. GDP decreases. **(10 points)**
b) Interest rates in the U.S. increase. No change in the Japanese rates**(10 points)**

2. Suppose that there is a fixed exchange rate system set up between Country A and Country B. (Suppose that the currencies are A dollars (A$) and B dollars (B$), respectively).

a.) Consider the exchange rate as B$/ A$ (i.e., as the price of A$ in the y-axis and the quantity of A$ in the x-axis). Suppose that this fixed exchange rate (E (fixed)) is greater than the equilibrium exchange rate (E*). Place E (fixed) and E* on a relevant graph, including supply/demand curves. **(10 points)**

b.) If the government of Country A wants to directly support this exchange rate, which currency (A$ or B$) must it supply to the market? Briefly explain. **(10 points)**

3. Suppose Country C increases its government spending.

a.) Without considering the effect on international markets, show (on an AS/AD graph)what happens to equilibrium GDP in Country C. **(10 points)**

b.) Show(on a relevant graph) what happens to interest rates in Country C. **(10 points)**

c.) Show (on a relevant graph) how the change you detailed in b) affects the value of Country C's currency relative to the $. **(10 points)** d.) Which component of AE (Aggregate Expenditure) will be most affected by the change you detailed in c) (i.e. change in exchange rates)? Will it increase or decrease? **(10 points)**

4. Why does inflation in Mexico lead to an appreciation of the dollar? Use an appropriate graph. Use the quantity of $ in the x-axis. **(10 points)**

5. Until the early 1980s, Japan had required its large insurance companies to invest all their vast holdings in Japanese securities. At the prompting of the United States, Japan relaxed the restrictions and allowed the companies to invest anywhere in the world. What effect do you think this had on the yen/dollar exchange rate? (Use an appropriate graph) **(10 points)**