



**ECON303**

**International Money and Finance**

**Session 1, 2014**

**Assignment 1**

**Instructions:** Please answer all questions. Note that the answers have to be typed. All questions related to the AA-DD analysis should contain neatly presented graphs. The assignment has to be submitted to turnitin. Note that apart from correct answers, the clarity of exposition, the depth of arguments and the overall presentation will be assessed.

**Question 1 (10 marks)**

Using 3-5 papers from Google Scholar (1 from the 1980s, 1 from the 1990s and one from the 2000s) as references briefly (around 700-800 words) discuss the empirical evidence on purchasing power parity.

**Question 2 (10 marks)**

In the standard AA-DD framework it is assumed that there is a 100% pass-through. What would happen to the AA and DD schedules if the pass-through is lower than 100%? Would this change monetary and fiscal policy effectiveness under a flexible exchange rate? How would this change the effects of devaluation under a fixed exchange rate?

**Question 3 (10 marks)**

Using the AA-DD framework and assuming the flexible exchange rate regime, analyse how a permanent change in tastes of domestic consumers making them to prefer domestic goods over foreign goods, would affect domestic economy in the short-run and in the long-run. Discuss what would happen to output, the nominal and real exchange rates and the current account. Assume that the economy starts in the long-run equilibrium with full employment.

**Question 4 (10 marks)**

Using the AA-DD framework, analyse the effects of a permanent decrease in the foreign nominal supply of money on the nominal and real exchange rates, domestic output and current account under the fixed and flexible exchange rates. Assume that the economy starts in the long-run equilibrium with full employment.