

ECO 365 - International Monetary Economics

SHORT-ANSWER QUESTIONS

1. [10 points] Why do most economists worry about the US current deficit?
2. [10 points] Why does globalization sets constraints on governments' capacity to raise the revenues?
3. [10 points] Explain the IMF morall hazard theory.

QUESTIONS FROM THE BOOK

4. [10 points] A Canadian buys a share of German stock, paying by writing a check on an account with a Spanish bank. Explain how the following transaction shows up in the balance of payments accounts of Canada.
5. [10 points] A tourist from Montreal buys a meal at an expensive restaurant in Barcelona, Spain, paying 200 Canadian dollars worth in Euros with a Visa credit card issued by CIBC. Explain how the following transaction shows up in the balance of payments accounts of Canada.
6. [10 points] Suppose the Canadian Dollar exchange rates of the Euro and the Yen are equally variable. The Euro, however, tends to depreciate (appreciate) unexpectedly against the Canadian dollar when the return on the rest of your wealth is unexpectedly high (low), while the Yen tends to appreciate (depreciate) unexpectedly in the same circumstances. As a Canadian resident, which currency, the Euro or the Yen, would you consider riskier?

PROBLEM

7. [40 points] Consider the two-period small open economy presented in class. Lifetime utility is given by $U = \log(C_1) + \beta \log(C_2)$. The endowment each period is $Y_1 = 10$ and $Y_2 = 35$; agents start period 1 with zero net foreign wealth, $B_1 = 0$. The interest rate in global capital markets is 50 percent, $r = 0.5$. Finally, assume that $\beta(1+r) = 1$.
 - a. Write the two period-by-period budget constraints and the intertemporal budget constraint (define any new variables that you use).
 - b. Solve for consumption in each period. (Note: Recall that $\frac{\partial \log(C)}{\partial C} = \frac{1}{C}$).
 - c. What is the current account in the first period? Does the agent borrow or lend in international markets in the first period? If so, how much?
 - d. Explain the relationship between international borrowing and lending and intertemporal trade (in terms of present and future consumption).