

910003 - International Monetary Economics

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Final Exam

Questions assigned:

Variato short 1: Why does the BOP always “balance”?

Variato short 2: What is an undervalued currency? What is an overvalued currency?

Variato short 3: What is meant by the term overshooting? What causes it and how is it corrected?

Toporowski long: What is the difference between a fixed exchange rate regime and a currency union? (hint: one of them needs more foreign exchange reserves). Are flexible wages necessary for a regional currency union to work?

Variato long 1: Under the gold standard all national governments promised to follow the “rules of the game.” This meant defending a fixed exchange rate. What did this promise imply about a country’s money supply? Using this theoretical explanation discuss why did the fixed exchange rate regime of 1945–1973 eventually fail.

Variato long 2: Discuss and critically compare the main monetary models faced during lectures: main properties, advantages and drawbacks

- Deadline July 3rd 2017
- The answers must be returned either physically, or by e-mail. The exam must be signed by the student either at the end and at the bottom of each page. The file sent by e-mail must be pdf format (be sure to ask for a receipt). If the answers are received after the deadline, the exam is failed.
- The exam consists of 4 compulsory questions selected but each student after they picked up 6 by chance:
 - Part 1: two short questions; each answer 600-1200 words (only the floor constraint strictly binding); weight on the final grade: 1/4.
 - Part 2: two long questions; each answer 1800-2500 words (only the floor constraint strictly binding); weight on the final grade: 3/4.
- Please use the present file format in order to return the final.

Underestimated Currencies

Take the instance of China, whose cash, the RMB (renminbi yuan), is asserted to have been reliably underestimated by the People's Bank of China (PBoC) since the mid-1990s.

Benefits of Undervaluation:

On the off chance that cash is underestimated, the fares will be less expensive, and they will develop prompting more noteworthy work in sending out businesses

Underestimated cash will make imports costly for customers, they will redirect to homegrown merchandise and along these lines work in homegrown businesses will increment.

Undervaluation gives a lift to China's exporters because the dollars they acquire convert into more RMB than they would something else.

Undervaluation likewise makes Foreign Direct Investment (FDI) more alluring to outside financial backers, since their monetary forms, say the US dollar (USD), convert into more RMB with which to purchase land, plants, or any nearby resource. The expense of building up FDI in China decreased, in say dollar terms, consequently boosting FDI in China from the remainder of the world.

The assumption for steady future undervaluation by the PBoC has made venture and occupations immerse China's fare area, transforming it into the "Production line of the World."

Undervaluation makes imports to China more costly in RMB, accordingly shielding homegrown Chinese firms from import rivalry and holding venture and occupations in the country.

An underestimated money helps speculation and occupations—something basic in a populace of 1.4 billion individuals.

Downsides of Undervaluation:

As talked about before underestimated money makes imports costly which additionally prompts Imported swelling for example every one of the items utilizing imported parts/crude material will become costly along these lines affecting the overall value level.

Successful security against imports through undervaluation implies decreased contest, which could likewise make neighborhood firms less serious.

In a country with a restricted work supply, the abundance of interest for occupations could raise compensation, which thusly could build expansion by and large. (This didn't occur in China for a long time as a result of its enormous populace. Notwithstanding, with the one-kid strategy at long last

unfamiliar trade hazards—that is, there are no forward rate agreements, and it utilizes just the normal spot rate.

Benefits of UIRP (Assumption)

Capital mobility in the market: The revealed loan fee equality expects ideal capital portability on the lookout.

Non-exchange condition: UIRP follows a no-exchange condition in the UIP condition. If the condition is abused, a danger-free return exists, and a chance to make a danger-free benefit unfurls.

Limitations of Uncovered Interest Parity

Expected rate of depreciation: Practical proof presumes that the normal pace of decline, which assumes a critical part in uncovered financing cost equality, is regularly not exactly the distinction that should be changed. Such a limitation frequently obstructs the productive working of the uncovered loan cost equality condition.

There is just restricted proof to help UIP, yet financial specialists, scholars, and examiners use it as anything but a hypothetical and theoretical structure to address effective assumption models. UIP requires the presumption that capital business sectors are proficient.

Experimental proof has shown that over the short and medium-term timeframes, the degree of devaluation of the greater yielding capital is not exactly the ramifications of revealed loan fee equality. Ordinarily, the higher-yielding money has reinforced rather than debilitated.

Differences

The viability of money-related arrangements and their effect has been mocked since the beginning of the Global Crisis. In the provisional, national banks turned out to be progressively worried about advancements in their economies' trade rates. Expanding worldwide monetary mix and the expanding distraction with trade rates call for returning to the essential assumptions of swapping scale balance: buying power equality (PPP) and uncovered financing cost equality (UIP).

The fundamental PPP relationship identifies with the current account and states that in aggressive global business sectors, the cost of a tradable good sold at home should rise to its cost abroad increased by the swapping scale. The UIP relationship identifies with the capital record and expresses that if capital streams are free and trade rates are adaptable, the perceived financing cost on