Exam ECON4330

Postponed

Spring 2025

The exam consists of three parts, Parts I, II and III. Each part gives different points. Carefully examine all pages so you do not miss any questions. Good luck!

1 Real Exchange Rate [50 points]

Consider a small open economy. What happens if the price of tradable goods increases? Focus on the real exchange rate, the price of non-tradable goods and wages.

2 Part II: Sovereign Risk [15 points]

(a) What type of risk does a creditor face when lending to foreign countries/sovereigns?

(b) Suppose that creditor have the possibility to impose sanctions in the case of defaults. Explain why this can make a borrowing country better off.

3 Part III: Mundell-Fleming-Tobin Model [35 points]

Assume the following (reduced-form) model:

$$Y = C(Y, E, i) + G + X(E, Y) \tag{1}$$

$$\frac{M}{P} = m(i, y) \tag{2}$$

$$\frac{B}{P} = W_p(E) - f(i, E) - m(i, Y) \tag{3}$$

$$F_g + F_p(i, E) + F_\star \tag{4}$$

where (1) is the is the IS curve, (2) is the LM curve, (3) is the BB curve, and (4) is the FX curve. Further, assume a fixed exchange rate regime where the interest rate is exogenous.

(a) Sketch the MFT model graphically. Explain the slope of the LM curve. Why is the LM curve steeper than the BB curve?

(b) Explain what sterilization of the money market is.

(c) Assume an exogenous increase in government expenditure, G. Sketch the shock graphically and compare sterilization with fixed interest rate.

(d) Now assume a floating exchange rate regime. Sketch the difference from fixed exchange rate and explain why the relationship between i and Y (the IS curve) looks different under the floating and fixed exchange rate regime.