Monmouth COLLEGE

- Name: ____________________
- Date: ____________________

ECON 301: Intermediate Macroeconomics

Quiz #5

Spring 2025

INSTRUCTIONS:

- Please read all questions carefully before you begin answering.
- Answer all questions in the spaces provided on the question sheet.
- This quiz consists of 7 pages, including this one. There are a total of 5 problems with a total of 14 subquestions.
- This is a closed-book quiz. Please remove all materials from the top of the desk and take any necessary items from your bags before the exam begins.

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Problem 1. Definitions **(5 Points Each)**

Select four items on the list of items below, and provide a definition of the items that you chose.

- Interest Rate Parity
- Nominal Exchange Rate
- Real Exchange Rate
- Net Exports
- Marshall-Lerner Condition
- Devaluation of Currencies

1.A. Item #1: ____________________________________

1.B. Item #2: ____________________________________

1.C. Item #3: ____________________________________

1.D. Item #4: ____________________________________

Problem 2. True / False **(5 Points Each)**

Determine whether the following statements are either `TRUE` or `FALSE`. If you deem that the statement is `TRUE`, there is no need to justify your answer. If you deem that the statement is `FALSE`, you MUST justify your verdict by providing an explanation.

2.A. A devaluation of the domestic currency alone is sufficient to decrease the trade deficit.

2.B. If the price levels in two countries are identical, then the nominal and real exchange rates between their currencies must also be identical.

2.C. If the domestic central bank adopts expansionary monetary policies, the country's currency is expected to appreciate.

2.D. If a foreign trade partner's economy expands, domestic exports are likely to increase.

Problem 3. Exchange Rates and Interest Rates **(12.5 Points Each)**

Suppose a U.S. investor with a $1,000 budget is considering two investment opportunities in 2025: U.S. Treasury bonds (denominated in U.S. dollars) and Japanese government bonds (denominated in Japanese yen). Suppose that at this initial period, 100 Japanese yen (¥) can purchase 1 U.S. dollar ($), so $E = 100$ in 2025.

3.A. If the investor allocates all of their investments into U.S. Treasury bonds which guarantee a 10% annual return, how much in U.S. dollar terms would the investor have by the end of the year?

3.B. If the investor allocates all of their investments into Japanese bonds which guarantee a 20% annual return, how much in Japanese yen terms would the investor have by the end of the year?

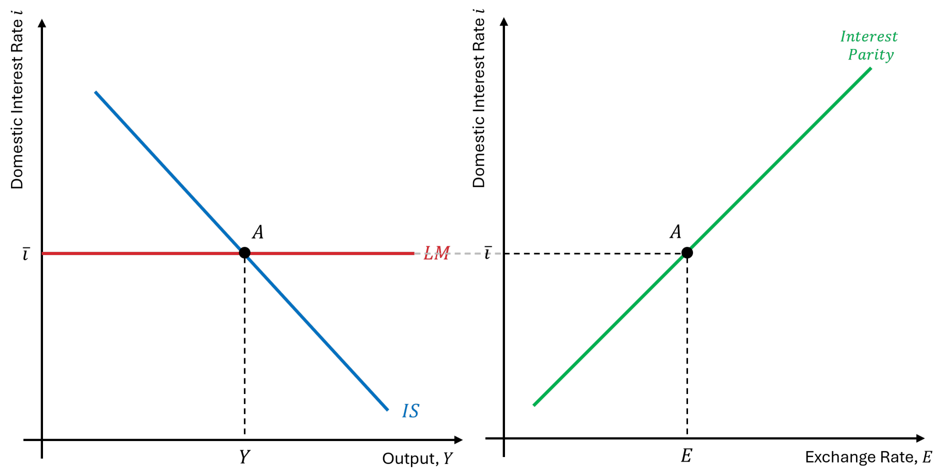
3.C. Suppose the investor chose to invest their money in U.S. Treasury bonds. Based on this observation, can you conclude that the investor expects the U.S. dollar to appreciate against the Japanese yen in 2026?

3.D. Calculate the nominal exchange rate in 2026 that would make U.S. and Japanese bonds equally attractive to the investor.

Problem 4. Policy Interactions in an Open Economy **(12.5 Points Each)**

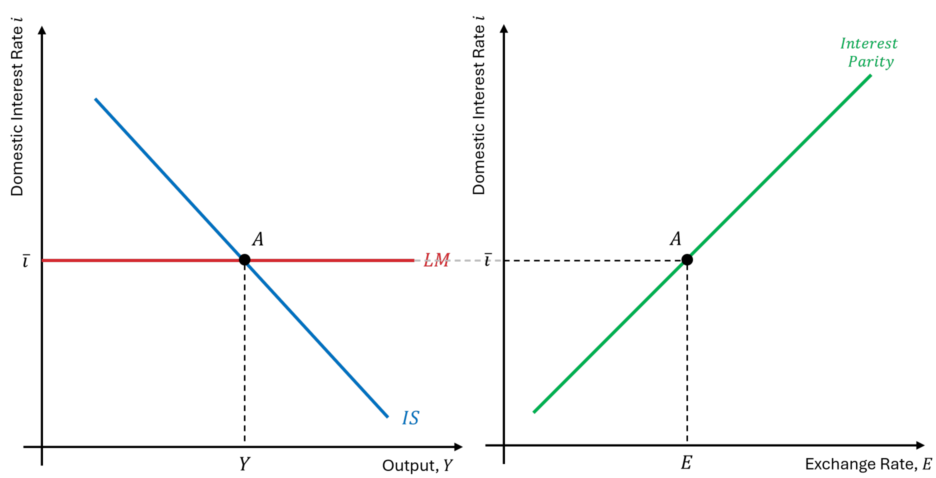
Suppose that an open economy is currently operating at point A, producing at the potential output level. The government is concerned about its budget deficit (not the trade deficit) and is considering cutting government spending to address it.

4.A. Illustrate and label the new equilibrium (and any changes in the IS, LM, or interest parity curves) following the government's fiscal contraction.



4.B. Due to changes in fiscal policy, the Federal Reserve is concerned that the economy will not be producing at its potential output level. In the diagram below:

- Repeat your answer from `4.A`, and then
- Illustrate and label the new equilibrium (and any changes in the IS, LM, or interest parity curves) following the Federal Reserve's response to the fiscal contraction.



Problem 5. Fiscal Policy, Net Exports, and Consumer Welfare **(10 Points)**

5.A. Discuss why a decrease in government expenditure may lead to a reduction in the country's trade deficit, and explain how this might affect households. You may use graphs, equations, or logical reasoning to answer this question.

- Original Score: ______________________
- Recovered Score: ______________________
- Original Date: ______________________
- Recovered Date: ______________________