Econ 8510/Chatterjee
Assignment 2
Due on: Wednesday, September 26 (in class)
Total Points: 100

Question 1
Answer the following questions with reference to the Keynesian models of the open economy discussed in class.

i. In what respects do the Keynesian open economy models differ from their classical (monetary) counterparts? Explain clearly.

ii. What aspects of the data or predictions of the monetary model do the Keynesian models seek to explain or refine?

iii. What is "over-shooting"? Explain the circumstances under which it may occur and discuss why this might be considered "stabilizing" behavior.

[7+7+6=20]

Question 2
In class we discussed the effects of monetary policy on the nominal exchange rate in the context of the Mundell-Fleming and the Dornbusch "over-shooting" models. In this exercise, you will be required to analyze the effects of a fiscal shock, say a permanent increase in government spending, on the nominal exchange rate. Your answers must include (a) an algebraic exposition, (b) a graphical illustration, and (c) a clear intuitive explanation.

What would be the effect of a permanent increase in government spending on the long-run nominal exchange rate and its dynamics in the following scenarios:

i. In the Mundell-Fleming model, when the exchange rate regime is (i) fixed, and (ii) flexible. Clearly compare your answers in each scenario with those for a monetary shock.

ii. In the Dornbusch "over-shooting" model. Compare your results with those of a monetary shock.

[25+25=50]

Question 3
Refer to the following article for this question:
Write an essay (typed, please) summarizing the contribution of this article to the research on exchange rate forecasting using monetary fundamentals. In your essay, focus on the value-added of this paper relative to both the earlier (pre-1995) and recent literature on this issue (post-1995). Feel free to elaborate on any critical comment that you might have on this paper or the issue in general. Provide a list of references you consulted for this essay.