Macroeconomic Policy in the World Economy
Additional Homework Problems
ECON 3133
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Answers

1.
   a. Both domestic credit and bank reserves increase by $10 billion.
   b. Both foreign reserves and currency decrease by $10 billion.
   c. Foreign reserves decrease and domestic credit increases by $10 billion.

2.
   a. Once the real interest rates rise in Canada, capital inflows from the United States will generate increased demand for Canadian currency, placing upward pressure on Canadian exchange rates. A successful expansionary policy also places upward pressure on interest rates and exchange rates from output gaps and inflation gaps. All three of these effects combine to place enough pressure on exchange rates that a policy to keep them fixed is not sustainable.
   b. To keep the Canadian dollar from rising, the United States needs to sell foreign reserves.

3.
   a. $R = 0 + 0.5 \times (0 - 0.01) + \beta_Y \times 0 + 0.01 = 0.005$ or 0.5 percent.
   b. No. Since $R = 0$, the zero bound on nominal interest rates makes it impossible for central bankers to stimulate the economy or conduct monetary policy according to the Taylor rule.