Introduction to International Economics, Paolo Paesani

MOCK EXAM

Question 1. Keynesian open economy model

Answer the questions below, based on the following data

1. $Y = C + I + G + X - M$
2. $C = 80 + 0.8(Y - T)$
3. $I = 200 - 1000r; \quad r = 0.15$
4. $G = 800$
5. $T = 100 + \ 0.20Y$
6. $X = 100 + 0.002Yw - 100e; \quad Yw = 40.000, \ e = 1$
7. $M = 100 + \ 0.2Y + 150e; \quad e = 1,$

a. Calculate the equilibrium values of GDP, government budget balance, net exports and change in the country's IIP (assume X – M = CAB = FAB) and clarify whether under this assumption the country is a net lender or a net borrower with respect to the rest of the world.
b. How do these values change if the domestic currency appreciates by 20% (e rises from 1 to 1.2) and why? Calculate the new equilibrium values and explain what happens to GDP, net exports and the government budget balance, using the concept of the open economy multiplier.
c. What can the government do to mitigate the impact of the domestic currency appreciation on GDP?
d. What can the central bank do to mitigate the impact of the domestic currency appreciation?
e. How do the initial equilibrium change if the world GDP Yw rises by 20% and why? Calculate the new equilibrium values and explain what happens to GDP, net exports and the government budget balance, using the concept of the open economy multiplier.

Question 2. Foreign exchange rates

1. Comment on the graph below, which shows the Euro – Canadian dollar exchange rate over the last 5 years.
2. Based on your answer to the previous question and your understanding of the FOREX market, how could you explain the fall from 1.6 (dollars per euro) to 1.3 (dollars per euro)? What are the implications of this fall, all other things equal?
3. Who demands Canadian dollars on the European FOREX market and why?
4. Who supplies Canadian dollars on the European FOREX market and why?

1 EUR uguale a

1,50 Dollaro canadese

25 ott, 05:41 UTC · Limitazione di responsabilità

1	EUR
1,50	Dollaro canadese

Segui

1G 5G 1M 1A 5A Max

Question 3. Balance of payments

ESTONIA BALANCE OF PAYMENTS

	09/2023	10/2023	11/2023	12/2023
1 CURRENT ACCOUNT	**-89.5**	**-121.2**	**3.0**	**324.8**
11 Goods and services	18.6	-33.6	88.8	93.6
111 Goods	-154.9	-247.7	-128.0	-193.6
112 Services	173.4	214.2	216.8	287.2
12 Primary income	-109.1	-68.3	-66.8	-80.6
13 Secondary income	1.1	-19.4	-19.0	311.8
2 CAPITAL ACCOUNT	**88.7**	**27.7**	**145.6**	**-116.5**
Net lending (+) / net borrowing (-) (balance from current and capital accounts)	**-0.8**	**-93.5**	**148.6**	**208.3**
3 FINANCIAL ACCOUNT	**-22.0**	**-206.1**	**31.5**	**164.7**
31 Direct investment	241.1	-35.2	-35.0	-1,881.8
311 Assets	395.2	49.6	77.7	74.8
312 Liabilities	154.1	84.8	112.7	1,956.6
32 Portfolio investment	599.1	-368.0	137.6	21.9
321 Assets	85.1	-170.9	158.0	-112.0
322 Liabilities	-514.0	197.1	20.4	-134.0
33 Financial derivatives (other than reserve assets) and employee stock options	-3.2	-20.6	-16.8	-11.4
34 Other investment	-1,139.1	213.8	194.1	2,051.6
341 Assets	-288.1	226.4	-175.2	1,975.8
342 Liabilities	851.0	12.6	-369.3	-75.8
35 Reserve assets	280.1	3.9	-248.4	-15.6
Statistical discrepancy	**-21.2**	**-112.6**	**-117.1**	**-43.5**

https://statistika.eestipank.ee/#/en/p/300/r/1877/1725

1. Briefly comment the table above, focusing on the current account and on direct investment.
2. What is the difference between direct investment and portfolio investment?
3. Complete the following sentence, which refers to the Table above "In December 2023, Estonia was a net lender with respect to the rest of the world, as indicated by the positive values in the b) … and c) … This implies that Estonia's NIIP, defined as the difference between d) …. and e) …. , f) ….
4. What does the negative value of the statistical discrepancy (net errors and omissions) indicate?

BONUS QUESTION (Max 2 points)

Discuss the implications of a negative current account balance and what the government can do about it.