Term Test 2 - Version B

1. Multiple Choices: (3'*7 = 21 points). *Only one correct answer unless otherwise stated.* Please write your answers in the bubble sheet on the last page. Answers written anywhere else will NOT be graded.

1. Which of the following events will cause the smallest decline in the real exchange rate? Denote the domestic and the foreign price level by P and P*, respectively.

a) an 8% nominal depreciation and an 8% reduction in P*

b) an 8% increase in P and an 8% reduction in P*

c) an 8% nominal depreciation and an 8% increase in P*

d) a 3% nominal appreciation and a 3% increase in P

$$\varepsilon = \frac{EP^*}{P}$$

$$\varepsilon = \frac{1.08E \cdot (0.92)P^*}{P} = 0.9936\left(\frac{EP^*}{P}\right)$$

2. Given the current output, Y0, which distance represents the country's imports?



ZZ = C+I+G+NX (Aggregate demand)

DD = C+I+G