

PROBLEM SET #4 (2 % of grade; 10 points possible)

DUE:- via Gradescope, no later than 8 pm on Tuesday November 26

Problem sets must be uploaded and submitted by 8 pm. Problem sets submitted in the 24 hours after the due date will be assessed a 5 point penalty. Your submitted work must be your own: Problem sets that are identical (in whole or in part) to another student's problem set will receive a zero. Essay must be submitted twice: as the last page(s) of your pdf of this problem set and electronically via bCourses.

IMPORTANT: Your answers must be on this sheet, with this formatting. You can hand write or type, but you can't reformat the questions.

1. **(1.5 points) Exchange Rates** Assume a floating exchange rate system. For each event below, draw a graph depicting the effect of the activity on the market indicated in the prompt. Label everything clearly. Predict the effect noted in the prompt. Briefly (one or two sentences) explain your graph.

A. (Dollars and Euros, from the perspective of the US, P_{ϵ} on vertical axis) The Federal Reserve – but no other central bank – decides to decrease interest rates. Predict effect on \$ price of 1 € and whether \$ rises or falls relative to €.



B. (Pounds and Euros, from the perspective of Britain, P_{ϵ} on vertical axis) The possibility (likelihood?) of Britain exiting from the European Union (“Brexit”) leads many Europeans to decide that holding their wealth in British assets is a bad idea. They sell their British stocks and bonds and put the proceeds into money market funds denominated in Euros. Predict effect on £ price of 1 € and whether £ rises or falls relative to €.



C. (Dollars and Chinese Yuan (RMB), from the perspective of the US, P_{RMB} on vertical axis) The surprising announcement by Trump of additional tariffs on goods manufactured in China leads many to expect trade from China to the US to fall. Predict effect on US\$ price of 1 RMB and whether US\$ rises or falls relative to RMB.



5. (1 point) Yield Curve.

- A. Using the axes at the right, draw a yield curve. (Note that in the textbook, page 226, the yield curve is missing labels on the horizontal axis. It should show 3 months, 1 year, 5 years, 10 years, etc.)
- B. Which “end” of the yield curve does the Fed have the most control over? Which “end” of the yield curve has the most influence on aggregate demand? Discuss.



6. (1.5 point) Phillips Curve

- A. At the right, draw a typical Phillips Curve.
- B. (1 point) Why is a decrease in the unemployment rate expected to lead to an increase in the inflation rate? What is one possible reason the recent data show no (or very little) increase in the inflation rate despite the fall in the unemployment rate?



7. (3 points) Essay

Go to the website for the Federal Reserve, then to the FOMC - meeting calendars & statements page at <http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>. Then look at the statement the FOMC issued after its October 29-30, 2019 meeting.

Write a 1 to 2 page paper in which you do the following:

- Choose two different sentences in the statement that you understand today that you probably wouldn't have understood in August. For each, first quote the sentence, then explain what the sentence means using the concepts and language we have learned this semester. One paragraph for each sentence and explanation. It'll probably look nice if you offset the quoted sentence with italics or a bullet or something like that.
- Choose one different sentence in the statement that you still don't understand today. Quote the sentence, then identify which (part of) the sentence you don't understand. If you can make a guess at the sentence's meaning, share your guess.
- In recent years, the Fed has sought to explain clearly what they are doing and why. In your fourth and final paragraph, discuss to what extent you think a little bit of economics education (say, a 1-semester course in micro & macro) is necessary for someone to be able to understand the Fed's statements.

Remember that in economics (as in life), the conclusions you come to will depend in part on the assumptions you make. So be sure you make the relevant assumptions explicit. Don't invoke wildly unrealistic assumptions; the assumptions you make should be reasonable.

Your essay must be your own work. To present anyone else's work as your own is theft of intellectual property: plagiarism. That means you must use quote marks " " around any words you quote exactly from any source (and then provide the source for the quote). It also means that if you get ideas from anyone else, or if you paraphrase someone else, you must again give them credit for their ideas. To do otherwise is plagiarism: the theft of intellectual property, a violation of the Code of Student Conduct and one of the worst offenses in academe. If you have questions about whether or not you've properly cited your sources, please talk with your GSI, the Head GSI, or Prof. Olney.

"Your own work" also means that essays crafted jointly on piazza or otherwise are not acceptable. That too is plagiarism.

Specifications: 600 words maximum, two page maximum. Double space. 10-11-12 pt font. 1" margins on all sides. Your name, date, and the word count in the top right corner. For submission on gradescope, your essay should be the last page(s) of your pdf file.

Submission: Essay must be submitted twice. [1] To gradescope, as the final page(s) of your problem set sheets. [2] To bCourses, assignments tab, just the essay. Acceptable formats: doc, docx, pdf. bCourses will check your paper using TurnItIn to ensure you have not plagiarized from published sources or previously submitted papers. GSIs will likely grade in gradescope.

Grading: 0 - 1 - 2 - 3 points, taking into account content, following specifications, and writing quality. No submission on bCourses results in a 0 on the essay.