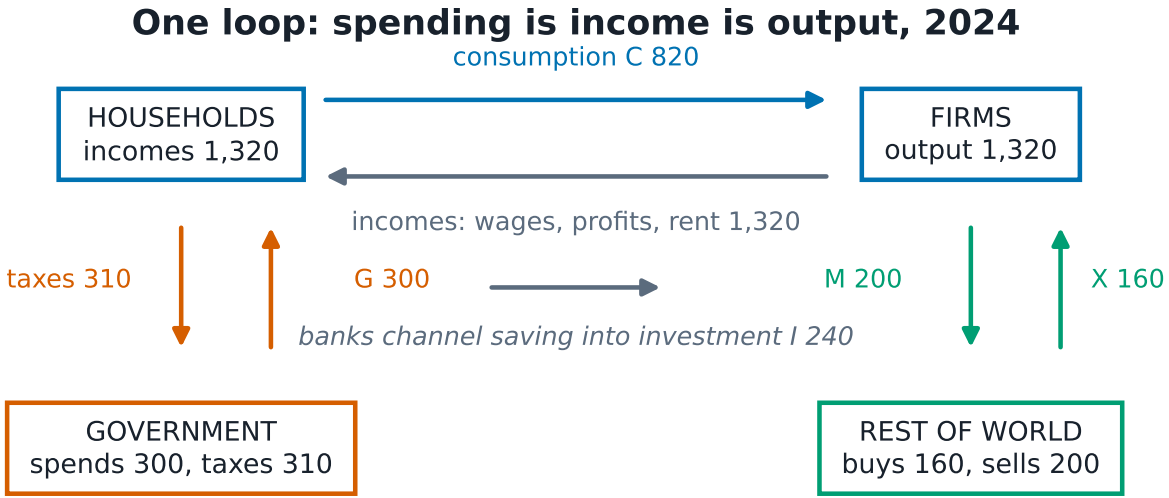
Exercise walk-through

4.6
International linkages

University Business

National accounts: the loop closes at 1,320

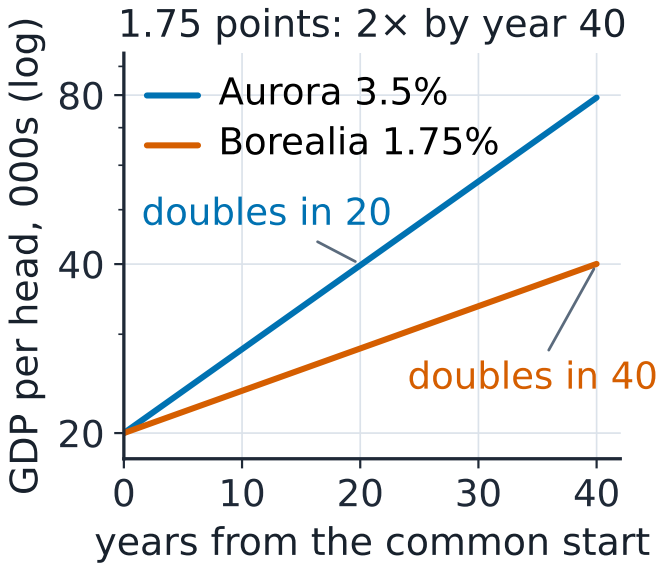


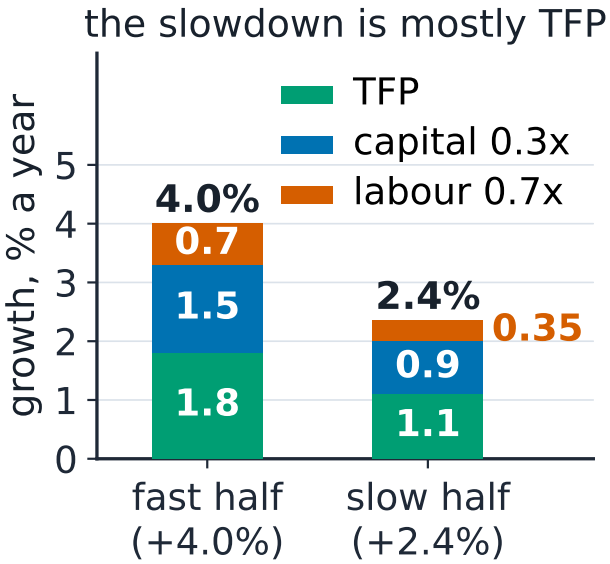
Y = 820 + 240 + 300 + 160 - 200 = 1,320 (both sides close)

C + I + G + X - M = 1,320, and income closes at the same 1,320.

Growth: small rates, compounded

Small growth gaps compound, and where they come from

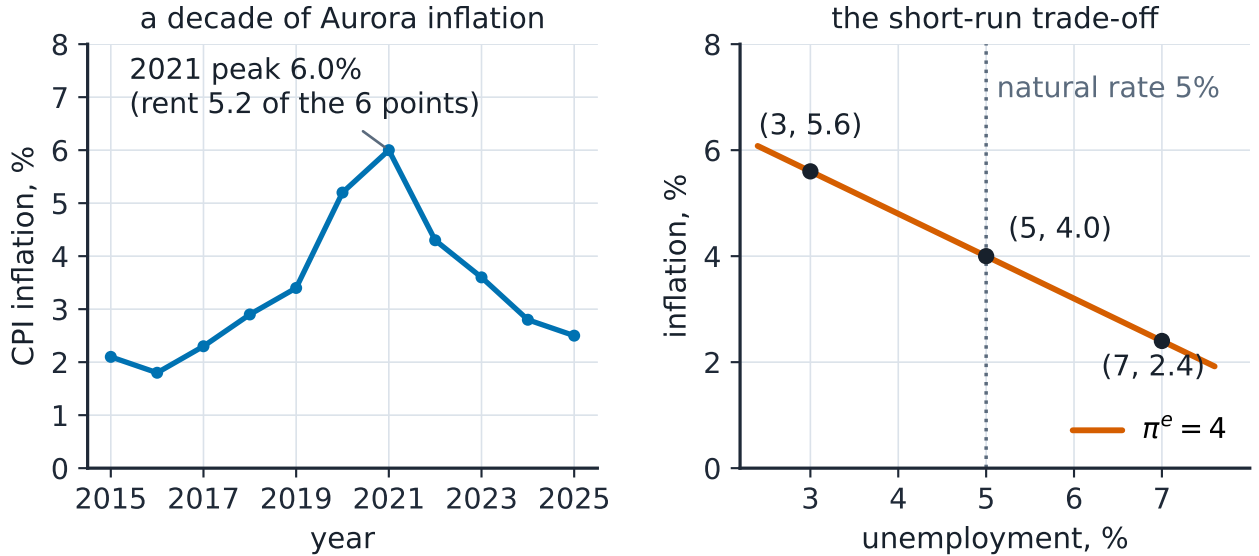




On a log scale, 3.5% growth doubles in 20 years, 1.75% in 40.

Inflation: audit the index

Prices and jobs: an index you can audit, a trade-off that expires



CPI 106.0 means 6% **inflation**; the trade-off holds until expectations move.

Exercises 2.1·2.2

2.1 Compute the current account balance and the financial account balance. [2]

2.2 What does your current-account answer say about saving and investment? And who is financing whom? [2]

Exercises 2.1·2.2

2.1 Compute the current account balance and the financial account balance. [2]

2.1

- CA $= (210 - 180) - 12 + 4 = +\mathbf{22}$.
- Financial account $= -\mathbf{22}$ – the country invests abroad.

2.2 What does your current-account answer say about saving and investment? And who is financing whom? [2]

2.2

- $CA = S - I = +22$: national saving exceeds investment by 22.
- The country is a net LENDER to the rest of the world.

Exercises 2.3·2.4

2.3 The same basket costs 900 in pounds at home and 1,170 in dollars abroad. Compute the PPP rate. The market rate is 1.20: which currency looks cheap, and what force should that set off? [3]

2.4 Home interest 4%, abroad 6%, spot 1.20 home-currency per foreign. Compute the UIP expected rate (three decimals). Who is indifferent under the model? [3]

Exercises 2.3·2.4

2.3 The same basket costs 900 in pounds at home and 1,170 in dollars abroad. Compute the PPP rate. The market rate is 1.20: which currency looks cheap, and what force should that set off? [3]

2.3

- PPP $= 1{,}170/900 =$ **1.30** dollars per home currency.
- Market $1.20 < 1.30$: the home currency looks CHEAP.
- The force: buy the cheap currency / its goods – exports and inflows should push the rate toward parity.

2.4 Home interest 4%, abroad 6%, spot 1.20 home-currency per foreign. Compute the UIP expected rate (three decimals). Who is indifferent under the model? [3]

2.4

- Expected rate $= 1.20 \times 1.04/1.06 =$ **1.177**.
- The home currency is expected to APPRECIATE about 2%.
- A saver comparing deposits is indifferent under the model – the 2-point rate gap is exactly the expected gain.

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Exercises 2.5·2.6

2.5 The country tightens monetary policy. In two lines, trace the exchange-rate channel to the current account. [2]

2.6 One line each: why is PPP a poor monthly forecast, and why do carry traders exist? [2]

Exercises 2.5·2.6

2.5 The country tightens monetary policy. In two lines, trace the exchange-rate channel to the current account. [2]

2.5

- Tightening → capital inflow → home currency appreciates → exports dearer, imports cheaper → the current account narrows (moves toward deficit).
- The exchange rate is a transmission channel, not a scoreboard.

2.6 One line each: why is PPP a poor monthly forecast, and why do carry traders exist? [2]

2.6

- PPP: baskets differ, transport and borders are real – it anchors decades, not months.
- Carry traders: UIP fails in the short run, so borrowing low and lending high can earn the gap without the offsetting depreciation – riskily.