Global Business Environment - FIN523
Fall 2018
http://moodle.epfl.ch/course/view.php?id=6271

Prof. Luisa Lambertini
E-mail: luisa.lambertini@epfl.ch
http://cfi.epfl.ch/Lambertini

Problem Set #6

due Monday November 11, 2019

PART I. *True, False, or Uncertain?* Give a brief explanation of your answer. Use diagrams if they are useful.

1. *(15 points)* Suppose that Moody's (rating agency) downgrades short-run government debt of the United States and, as a result, yields on U.S. Treasury bonds increase. The U.S. dollar appreciates relative to the Swiss Franc.

2. *(15 points)* The depreciation of the British pound following the Brexit referendum has brought inflation to 3%, above the inflation target of 2% of the Bank of England *(This is a fact)*. To bring inflation back on target, the Bank of England should lower its policy rate.

PART II.

1. *(15 points) Please give brief explanations.* What was the Stabilization Fund of the Swiss National Bank? What was its purpose? Was it traditional or nontraditional monetary policy? Would you consider it credit easing or quantitative easing?

2. *(45points)* Suppose the Home economy is in equilibrium with output at its full-employment level and the long-run expected exchange rate equal the spot exchange rate, $E^e = E^{lr} = E$. Suddenly the rest of the world adopts permanently a tariff on Home products.

   (a) *(22 points)* Please explain the effect on the long-run exchange rate.

   (b) *(23 points)* In a diagram with the Home money market at the bottom and the Home Foreign exchange rate market at the top, please show the short- and long-run effects of the tariff.