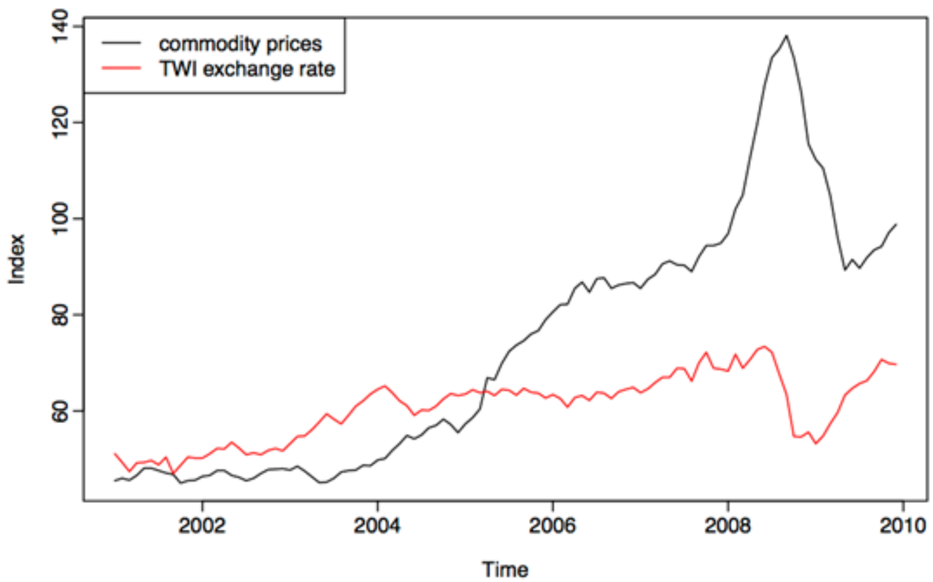
Introductory Macroeconomics

In-Tutorial #10
Week Starting 17th May 2021

Questions.

1. The following graph shows data on the average price of commodities (i.e., primary goods that Australia exports) and an index of Australia's trade weighted nominal exchange rate (foreign currency/AUD).[1] Explain why we may expect to see a positive relationship between commodity prices and the Australian trade weighted exchange rate? If anything, the TWI exchange rate leads commodity prices. That is movements in the exchange rate occur prior to movements in commodity prices. Why do you think that may occur?



2. Greece is a member of the Eurozone. It uses the Euro as its main currency. Hence, the Greek currency is fixed relative to other members of the Eurozone but the value of Euro fluctuates relative to other currencies. Hence we can view the Greek currency as being flexible relative to countries outside the Eurozone. Also note that for a prolonged period of time, the Greek government was spending more than it was raising in tax revenue. Creative accounting understated the size of government borrowing until the late 2000s before the real size of the government debt and deficit was revealed.

[1] A trade weighted nominal exchange rate is an average of the value of the Australian dollar against Australia's twenty largest trading partners. The weights reflect the importance of a country in trade.

(a) Suppose Greece had its own currency, say the Drachma, and a flexible exchange rate. Describe what would have happened to the exchange rate when the real size of the government debt was revealed? What effect would this change in the exchange rate have upon the real economy in Greece?

(b) Greece is a member of the Eurozone. What effect upon the Euro did revealing the size of government debt have upon the value of the Euro? What effect would this change in the exchange rate have upon the real economy in Greece?

(c) What do you think were the costs for Greece of joining the Euorzone, and what do you think have been the benefits?

3. We can think of Australia as a currency union. Each state in Australia uses the same currency. But different states in Australia have experienced different economic conditions over the last two decades. The mining boom has had beneficial effects for people in West Australia and Queensland. The decline of manufacturing sectors has had negative outcomes for people in South Australia and parts of Victoria and Tasmania.

   (a) What effect did the mining boom had upon the value of the Australian dollar?

   (b) What impact does this change in the Australian dollar have upon the real economy relative to an environment in which the Australian dollar was fixed?

   (c) If we look at economic performance across Australian states, there is much less variability in economic outcomes, than if we look at economic performance across European countries. For instance, unemployment rates in Australian states are much more similar than unemployment rates in European countries. Why do you think this is the case?