Problem 1. Home country pegs its currency to the USD. Both Home and US interest rate are 2%. Home output is 1000 when the interest rate is 2%, but Home output falls by 1 every time Home interest rate increases by 1 percentage point. There is no default risk.

- **(a)** Suppose the peg is credible. For US interest rates $i^* \in \{2, 3, 4, 5, 6, 7, 8\}$, determine corresponding Home interest rates and output.
- **(b)** Suppose the peg is not credible: everyone knows that Home government will allow depreciation of 1% for one year if output falls to 997 or lower. For US interest rates $i^* \in \{2, 3, 4, 5, 6, 7, 8\}$, determine corresponding Home interest rates and output.
- **(c)** Whether (a) or (b) holds depends on whether investors believe that the peg is credible. Regardless of beliefs, which US interest rates will not lead to speculative attack?
- **(d)** Regardless of beliefs, which US interest rates guarantee speculative attack?
- **(e)** At what US interest rate are there two equilibria?

Problem 2 (Partial Sample Final Question 1). Here, have some short answer questions.

- **(a)** In a hyperinflation, the rate of inflation exceeds ______% per month.
- **(b)** What is meant by home bias in an investment portfolio?
- **(c)** What is a currency board?
- **(d)** As of now (2022) how many countries are in the Eurozone? Which countries are the most recent to have joined?
- **(e)** Which two EU countries appear unlikely to join the euro?

Problem 3 (Sample Final Question 3). In the years leading up to the Great Depression, a key objective of the federal government was to balance the government budget.

- **(a)** Suppose that tax revenue collected by the government depends on income. During a recession, what happens to government tax revenues? What does this imply about the government budget?
- **(b)** If the government wants to keep the budget balanced, what type of fiscal policy must the government implement? Illustrate the effects of this policy using the IS-LM-FX diagram, assuming a floating exchange rate regime.
- **(c)** State how the fiscal policy affects Y, i, E, C, I, and TB. Is this a stabilization policy?
- **(d)** The US was part of the gold standard, fixing its exchange rate to the value of gold. Illustrate how the policy described in part (b) affects the economy differently under a fixed exchange rate regime. State how the fiscal policy affects Y, i, E, C, I, and TB.
- **(e)** How did the macroeconomic regime affect stabilization policy in this scenario?