

Econ 102 – Principles of Macroeconomics
Discussion Section Handout #12

Announcement:

The final homework is due this Friday, May 11 at 5:00 pm.

Key concepts:

Balance of payments, Current account and financial account, Depreciation and appreciation, Real exchange rate, Demand and supply analysis in the exchange rate market (the factors that shift the curves, the equilibrium)

Examples:

1. The following table shows the nominal exchange rate and the real exchange rate between the U.S. dollar and the British Sterling Pound in 2005 and 2006.

	2005	2006
Nominal exchange rate (£/\$)	0.4	0.75
Real exchange rate	0.5	0.5
CPI in U.S.	100	Y
CPI in U.K.	X	Z

- a. What's the value of X?
 - b. What are the values of Y and Z?
 - c. Which country had higher inflation during 2006?
2. The exchange rate market between the Euro and the U.S. dollar is initially at the equilibrium. Suppose the inflation rates in both EU and U.S. increase by 5%. Other things being constant, what would happen to the exchange rate (€\$)?
- a. U.S. dollar would be appreciated.
 - b. U.S. dollar would be depreciated.
 - c. The exchange rate between two currencies won't change.
 - d. The change in exchange rate is uncertain.