Assessment guidelines SØK2009 fall 2018

The compulsory readings are chosen chapters from the textbooks “International Economics” by Krugman, Obstfeld and Melitz (11th edition) and “Economics of Monetary Union” by De Grauwe (12th edition), as well as lecture notes.

<u>Question 1</u>
Question 1 is based on chapters 14 and 15 in the Krugman et al. textbook.

a) The foreign exchange market is described in chapter 14 (Figure 14-4 and related equations), the money market is described in chapter 15 (Figure 15-3 and related equations), and the complete foreign exchange – money market model is covered in chapter 15 (Figure 15-6). The relevant equations and graphical illustrations must be presented and explained, including the analytical solution for the equilibrium exchange rate.
b) Short-run and long-run effects of a permanent increase in the domestic money supply are illustrated by Figures 15-12 and 15-13. It is important to explain the economic intuition behind the effects. In particular, the concept of exchange rate overshooting should be discussed.

<u>Question 2</u>
Question 2 is based on the De Grauwe textbook.

a) It is useful to present a standard aggregate demand – aggregate supply model to discuss asymmetric shocks, as done in the lecture notes (Topic 1: “Effects of shocks and policies in a monetary union”). The basic asymmetric demand shock analysis is shown for France and Germany in Figure 1.1 in the textbook.
b) The automatic adjustment mechanisms include wage flexibility (covered in Figure 1.2) and labor mobility. Challenges related to the adjustment mechanisms should be mentioned (strong trade unions and language/cultural barriers for wage flexibility and labor mobility, respectively).
c) The problems with monetary policy and asymmetric shocks in a monetary union is covered in chapter 10.1, while the fiscal policy response to asymmetric shocks in a monetary union is shown graphically in the lecture notes. Limitations of fiscal policies due to government debt should be discussed. The analysis of policy outside a union should include expansionary monetary policy and/or devaluation. The effectiveness of these policies should be discussed (Figure 2.6).