



Prof. Frank Westermann, Ph.D.
Chair of International Economic Policy
Rolandstraße 8,
49069 Osnabrück

Exam in „International Finance“

Summer semester 2018

Total points: 60 Points

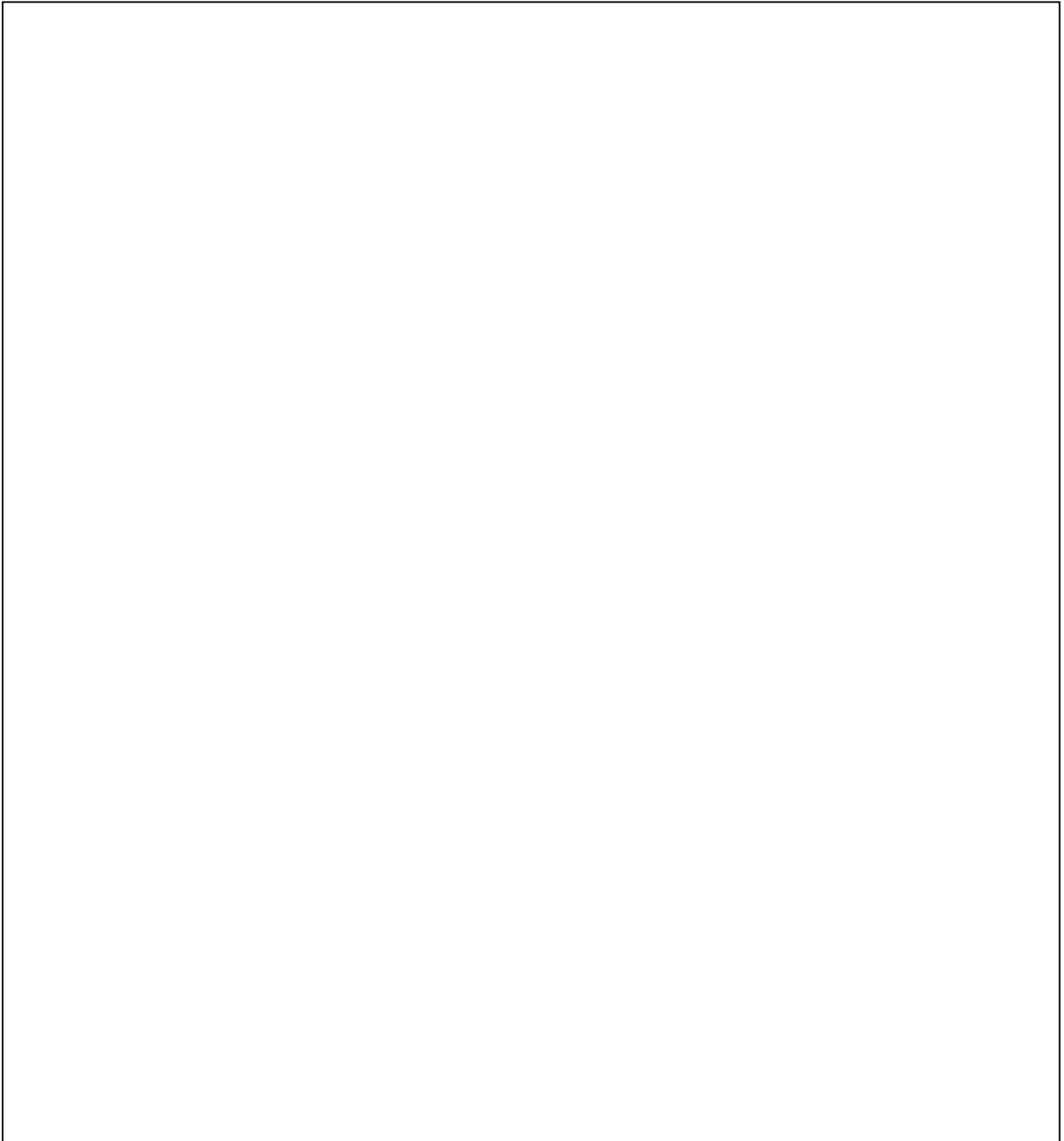
For all questions: Please label all graphics thoroughly and completely describe the notation of all formulas and variables!

Question 1: Mundell-Fleming Model (20 Points)

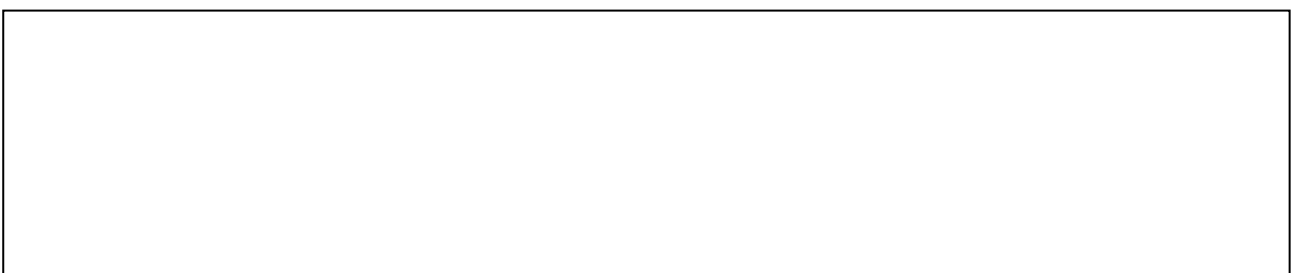
- a) Define the Balance of Payments and its determinants formally. (4 points)

- b) Using the total differential, explain why the ZZ-Curve has a positive slope. (4 Points)

- c) Explain the effects of an expansionary monetary policy in a flexible and a fixed exchange rate regime by using appropriate graphs. (Assume perfect capital mobility) (8 Points)



- d) Name two points of criticism regarding the Mundell-Fleming-Model. (4 Points)



Question 2: Interest rate parity and exchange rate determination (20 Points)

- a) Give a formal definition of the uncovered interest rate parity (UIP) between two countries with different currencies. (2 Points)

- b) The following two EViews-Outputs display the results of an empirical test of the uncovered interest rate parity between Germany and the USA.

with $\text{DIFF_E} \hat{=}$ Difference of the exchange rate between the two countries
 $\text{DIFF_R} \hat{=}$ Difference of the interest rates of both countries

Dependent Variable: DIFF_E
 Method: Least Squares
 Date: 05/02/18 Time: 14:14
 Sample: 2000M01 2017M12
 Included observations: 216

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.000205	0.003633	1.873118	0.3246
DIFF_R	0.998109	0.001122	889.7722	0.0000
R-squared	0.999896	Mean dependent var		3.096786
Adjusted R-squared	0.999895	S.D. dependent var		0.955741
S.E. of regression	0.009785	Akaike info criterion		-6.392331
Sum squared resid	0.007852	Schwarz criterion		-6.334455
Log likelihood	270.4779	Hannan-Quinn criter.		-6.369066
F-statistic	791694.6	Durbin-Watson stat		1.260983
Prob(F-statistic)	0.000000			

Wald Test:
 Equation: Untitled

Test Statistic	Value	df	Probability
F-statistic	201021.4	(2, 146)	0.0000
Chi-square	402042.9	2	0.0000

Null Hypothesis: C(1)=0, C(2)=1
 Null Hypothesis Summary:

Normalized Restriction (= 0)	Value	Std. Err.
C(1)	-0.001522	0.002135
-1 + C(2)	-1.000665	0.001581

Restrictions are linear in coefficients.

- b) i) Write down the equation for the regression of the first output. (2 Points)

- b) ii) What values do you expect for the coefficients on the interest rate differential and the constant, if the uncovered interest rate parity holds? (2 Points)

- b) iii) Interpret the results of the two outputs with regard to the validity of the uncovered interest rate parity. (6 Points)

b) iv) Name two reasons why the uncovered interest rate parity often does not hold.

(2 Points)

c) Assume the exchange rate is determined by the monetary model (Dornbusch model). Graphically show and explain the effect of a domestic increase of the money supply. Start with the equilibrium situation on the money and exchange market and only consider the short-run effects. (6 Points)

Question 3: Boom-Bust-Cycles and growth (20 Points)

- a) Name two possible effects systemic risk can have on growth. (4 Points)

- b) The incentive compatibility condition in the 1-Sector-Model with risky investment is as follows:

$$u(1+i)b_t \leq h(w_t + b_t)$$

with $i \hat{=}$ interest rate, $b \hat{=}$ credit, $h \hat{=}$ measure for legal system, $w \hat{=}$ initial wealth

$1 - u \hat{=}$ probability of a systemic crisis.

Explain the equation and argue why it is necessary! (4 Points)

- c) Derive the financial multiplier starting from the following condition of the 1-Sector-Model with risky investment: $u(1+i)b_t = h(w_t + b_t)$ (6 Points)

d) How does the probability of crisis influence the credit volume?

(2 Points)

e) Does this result imply that risk-taking is a first-best, welfare enhancing policy?

(4 Points)

The Chair of International Economic Policy wishes you best success!

Please sign the exam on the last page before handing it in.