

Practice Problems: PPP and the Long Run Determination of E

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1. What makes Absolute PPP different from the law of one price?
2. Define Relative PPP (i.e., show the formula and tell what the variables are).
3. Suppose there are 2 countries, the USA and China.
 - a. If the US and Chinese inflation rates are the same, what do you predict the change in the exchange rate will be in the long run?
 - b. If the US has 2% inflation and China has 10% inflation, what do you predict the change in the exchange rate will be in the long run?