Practice Problems: Fixed Exchange Rate Basics
Throughout this problem set, assume the exchange rate is FIXED !!

1. Why might a country fix its exchange rate? (Your explanation should include at least 1 equation.)

2. In what sense does a central bank lose control of the domestic money supply under a fixed exchange rate regime?

3. Consider the effects of an unanticipated increase in real GDP in this county. Be sure to explain completely what happens in both the money and FOREX market diagrams and explain thoroughly any central bank action.

4. Consider the effects of an unanticipated increase in the foreign country's domestic nominal interest rate. Be sure to explain completely what happens in both the money and FOREX market diagrams and explain thoroughly any central bank action.

5. Consider the effects of an unanticipated increase in the foreign country's domestic nominal money supply. Be sure to explain completely what happens in both the money and FOREX market diagrams and explain thoroughly any central bank action.

6. Consider the effects of an unanticipated increase in the foreign country's real GDP. Be sure to explain completely what happens in both the money and FOREX market diagrams and explain thoroughly any central bank action.

7. Consider a wave of speculative concern (not a full attack) in the FOREX market that the home country will devalue.

8. Consider the effects of the central bank conducting an unanticipated devaluation of the currency. Explain how this is done. Why might they do this?

9. Consider the effects of the central bank conducting an unanticipated revaluation of the currency. Explain how this is done. Why might they do this?

10. Suppose the domestic central bank wants to buy foreign assets (e.g., currency) but doesn't want to change the fixed exchange rate parity. Explain with simple diagrams like we used in class how it can do this through sterilization.

11. Suppose the domestic central bank wants to sell foreign assets (e.g., currency) but doesn't want to change the fixed exchange rate parity. Explain with simple diagrams like we used in class how it can do this through sterilization.