ECON 136, Fall 2016
Homework #9
Due Dec. 5, 2016

1. Suppose we observe a one-year forward exchange rate of $1.28/£ at a time when the spot rate is $1.32/£.

    a. Does the forward market indicate an expectation that the £ will appreciate or depreciate relative to the $ over the course of the next year?

    b. By what percent is it expected to appreciate or depreciate? (Your answer should be a positive number. The sign is conveyed by the words "depreciate" or "appreciate."

    c. If the US interest rate on 10-year Treasury notes (a common benchmark rate) is 3%, what interest rate should prevail for the same bonds in the UK if interest rate parity is satisfied?

2. Monetary policy:

    a. What organization conducts monetary policy in the U.S.?

    b. When this organization engages in an expansionary policy, is it increasing or decreasing the creation of new money?

    c. What is the goal of an expansionary policy?

3. Fiscal policy:

    a. Who has primary responsibility for fiscal policy in the European Union: the European Central Bank or the governments of the individual EU governments?

    b. To carry out an expansionary fiscal policy, would the authorities cut tax rates or raise them? Cut spending or increase spending?

    c. What is the goal of expansionary policy?

    d. What expansionary policy did Trump and Clinton agree on? Answer: huge ("yuge?") infrastructure spending.

4. The "Federal Funds" interest rate is a key short-term U.S. interest rate that is targeted by the Federal Reserve

    a. What is the Fed's current target rate?

    b. What is the Fed generally expected to do in December: raise this rate, keep it the same, or lower it?

5. Deficit spending:
    a. How much was the Federal government's deficit for the fiscal year that ended Sep. 30, 2016?
    b. President Trump wants to increase infrastructure spending, reduce tax rates, and maintain benefits for Social Security and Medicare. And maybe increase defense spending while he's at it. What will be the mostly likely outcome if these policies are enacted?
        - Deficit will drop so much that it becomes a surplus
        - Deficit will be reduced slightly
        - Deficit will stay roughly the same
        - Deficit will increase slightly
        - Deficit will increase a lot