

Macroeconomics, Module 4 Assignment

Assignment 4 (Short-Answer and Algebraic Questions): *(The numbers in square brackets give the breakdown of the points for various parts of each question. To receive full credit, please explain your answers. Total of 70 points.)*

1. This question is based on the article, "[Hong Kong defends its dollar peg in both directions](https://www.economist.com/finance-and-economics/2018/04/21/hong-kong-defends-its-dollar-peg-in-both-directions)," published by *The Economist* on April 21, 2018 and available at <https://www.economist.com/finance-and-economics/2018/04/21/hong-kong-defends-its-dollar-peg-in-both-directions>. This is the same article that you have seen in the quiz for Module 4.
 - (a) The article points out that HKMA could have reduced the territory's money supply to avoid the market exchange rate reaching the upper limit of its policy range. Why had HKMA been reluctant to do so? [13 points]
 - (b) The article points out that Hong Kong's peg to the dollar has weathered many significant shocks since 1984 and has proven resilient. So, it makes sense to strongly expect the exchange rate to remain very close to 7.80HK\$/US\$ over the next several years. Assuming that the interest parity condition holds, what should be relationship between the risk-free, one-year interest rates in the US, i , and in HK, i^* ? Why? [12 points]
2. This questions is based on the article, "[The European Central Bank fires another salvo: Mario Draghi gets out his big bazooka](https://www.economist.com/finance-and-economics/2016/03/10/the-european-central-bank-fires-another-salvo)," published by *The Economist* on March 10, 2016 and available at <https://www.economist.com/finance-and-economics/2016/03/10/the-european-central-bank-fires-another-salvo>. The article describes the monetary policies of the European Central Bank (ECB) in 2015 and 2016.
 - (a) According to the article, which conventional monetary policy tools (open market operations, discount rate adjustment, and reserve requirement) has the ECB used in 2015 and 2016 to expand money supply and encourage lending? [10 points]

- (b) According to the article, what are the three unconventional monetary policy tools that the ECB has employed in 2015 and 2016 to expand money supply and encourage lending? [15 points]
- (c) According to the article, what factors motivated the ECB to employ highly expansionary, conventional and unconventional, monetary policies in March 2016? [8 points]
- (d) According to the article, what impact did the announcement of ECB's policy changes on March 10, 2016, have on the euro-dollar exchange rate? Did the euro's value decline or rise initially after the announcement? Was there any direction change in the value of the euro afterwards? What factors in the interest parity condition explain these changes? [12 points]