International monetary economics flashcard

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Because, they argue, Americans are living beyond their means. They say a trade deficit and inflow of foreign capital can be healthy if the U. S. Is investing in projects that generate future wealth. But in recent years, investment has been weak. Imported capital has primarily allowed U.

S. Consumers to go on a spending binge. In the third quarter, personal saving was Just 0. 4% of after-tax income, the lowest ratio since at least World War II.

As for the rise in Americans' wealth, some say it's largely he result of a bubble in the housing market.

2. Globalization sets constraints on governments' capacity to raise the revenues needed to manage exceptionally large debt-to-GAP ratios. As factors of production become more mobile, they become more difficult to tax. Companies can ever more readily move production to countries where tax rates are lower.

As global investment options expand, taxing wealth-holders has become harder too. Even labor cannot be relied on to remain at home.

Indeed, countries that fail to achieve offsetting efficiencies (for example, by keeping after-tax rates of return competitive through above-average productivity growth) may find it increasingly difficult to borrow as the 21st century rolls on. Otherwise, if a government allows its debts to rise too far, there will be an exodus of capital and labor that strains the ability to repay of the investors and workers who remain. Exacerbating this will be the

diminished ability of governments to borrow, even at home, without indexing debt to major currencies.

Indexation also pushes down levels of sustainable debt, as it increases vulnerability to exchange-rate adjustments that might otherwise be desirable.

3. Simply put, if lenders are confident they will ultimately be bailed out by heavily subsidized MIFF loans, they will extend too much credit to emerging-market debtors at rates that do not reflect the true underlying risk. QUESTIONS FROM THE BOOK 4. The purchase of the German stock is a debit in the Canadian financial account.

There is a corresponding credit in the Canadian financial account when the Canadian pays with a check on his Spanish bank account because his claims on Spain fall by the amount of the check.

This is a case in which a Canadian trades one foreign asset for another. 5. The tourist expenditure would be counted as a service import for Canada, and therefore as a current account debit. The signature on the Visa slip entitles the restaurant to receive 200 CAD from CUBIC, the company that issued the Visa card.

It is therefore, 1 an asset, a claim on a future payment from CUBIC.

Therefore, the tourist is selling an asset to Spain and generating a 200 CAD credit in the Canadian financial account. 6. The Euro is less risky for you. When the rest of your wealth falls, the Euro tends to appreciate, cushioning your losses by giving you a relatively high payoff in terms of International

Monetary Economics By Kenneth-Wang least painful, that is, when the rest of your wealth is unexpectedly high.

Holding the Euro therefore reduces the variability of your total wealth.

PROBLEM 7. A The two period-by-period budget constraints are: Yell +82 YE + (1 + r)BE = Q where 82 denotes the agent's stock of net foreign wealth at the end of period 1 . Combining these two equations, we obtain: Yell + That is, the present value of consumption over the lifetime needs to equal the present value of the endowment over the lifetime. B. The agent maximizes lifetime utility subject to the international budget constraint, r Max log(CO) + log((l + -CLC)+YE) The first order condition for this problem is which leads to CO= CO -c since + r) = 1 .

From the international budget constraint (??) it follows that C= (1 + r)YE + YE 1. 5 x 10+35 = 20 2. 5 and Bal = O, it follows that CIA ? -10. That is, in the first period the agent borrows 10 units of the consumption good in international capital markets.

2 d. A country with a current account deficit is importing present consumption and exporting future consumption. A country with a current account surplus is exporting present consumption and importing future consumption. 3