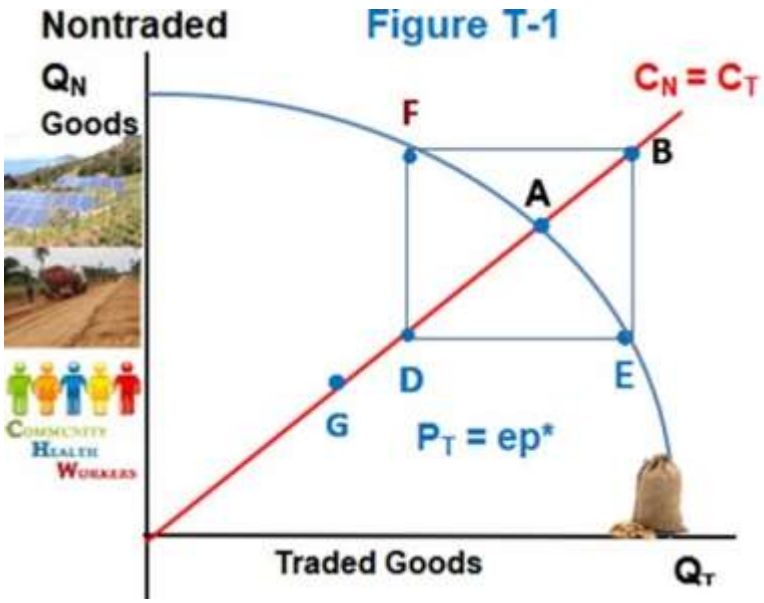
ECON 3235 Economics of Latin America **Quiz 2 Review Sheet** updated October 18th 2018

Quiz 2 is scheduled for Thursday October 18th 2018 at 5pm Back to Course Calendar….

There will be a review session before the Quiz at 3:30pm E530 (at 3:45 we will move to 202 Dealy) Review sessions depend entirely on your questions, last Sunday no one had any questions so had it not been Sunday we should have ended that session before it began (on a more positive note, everyone who attends a review session should get 1-3 points especially if they ask a question.

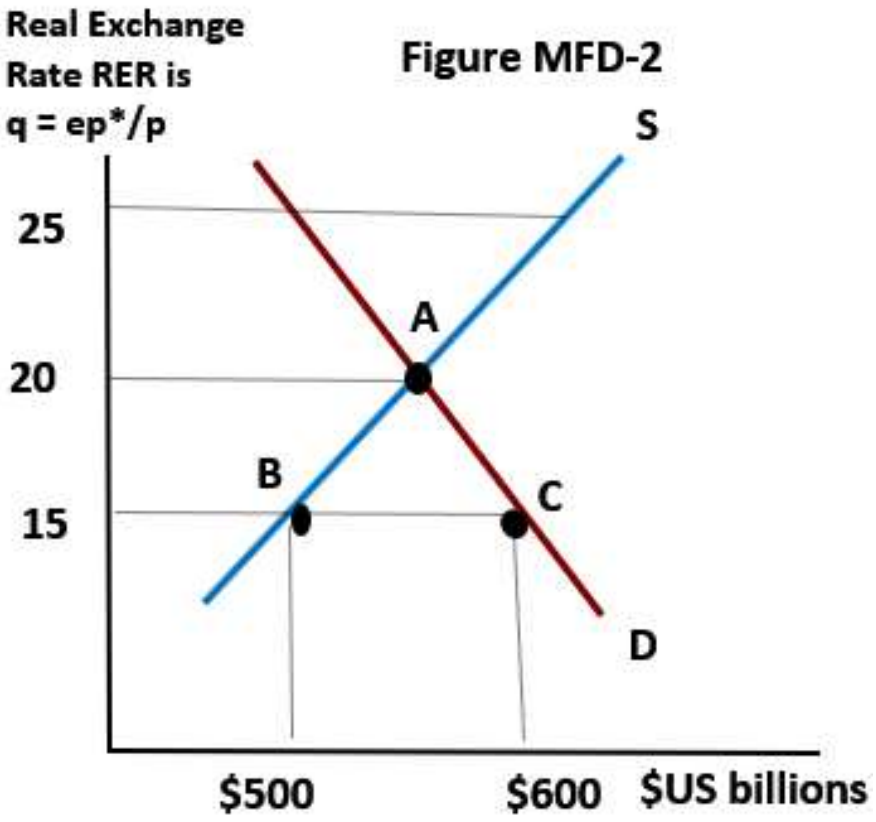
Q2-1 Use Figure T-1 to discuss the effect of capital inflows on the real exchange rate. Recall that $q = P_T/P_N$ Where $P_T = ep^*$ and now $P_N = p$ (domestic prices). Remember that in this model is the **TB = Q_T - C_T**. Capital inflows example: suppose consumers try to consume at B, how is this possible in a TNT world? What happens at B that naturally leads to and RER appreciation (a fall in q). Is the tail wagging the dog again? Suppose the authorities (who?) does not like inflation. What can they do to adjust to capital inflows and reduce inflation? What is the special bonus for doing this in emerging market economies with a long history of inflation and falling e?

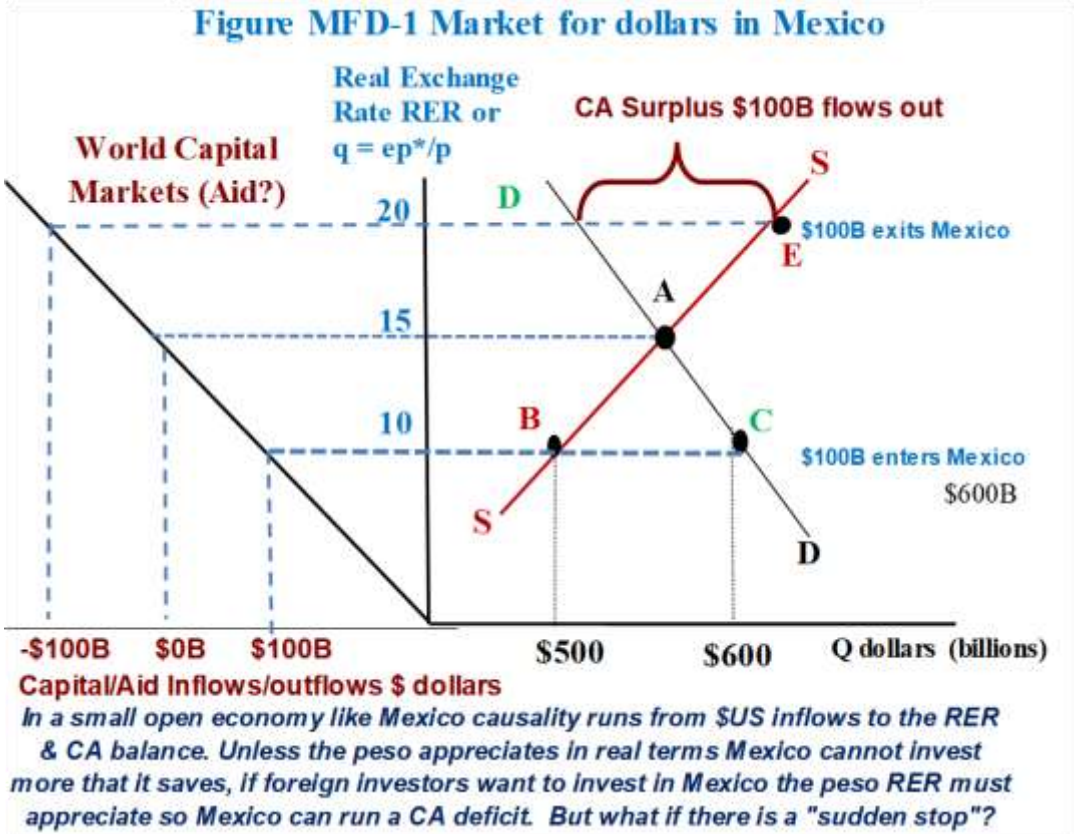
Q2-2 Use Figure T-1 to discuss what happens when capital starts to flow out of the country. How can this country generate a trade surplus and remain at full employment? Why is this very difficult without a flexible exchange rate? (adjusting to capital inflows is fun, adjusting to outflows is not, witness Argentina). Why might it be a good idea to call the IMF at this point? What is the disadvantage of calling the IMF (hint: beggar thy neighbor policies) *EC show how the Dutch Disease begins in Figure T-1, assuming the economy starts at A what will happen (unless the government takes mitigating matters). Is the DD really a disease?*



Q2-3 Suppose Puerto Rico wants to raise living standards and lower its debt, what should it do (or entice foreign investors like Elon Tesla to do)? How would this both increase its resilience and make it more competitive (lower q). What would this likely involve that Klein (2018) specifically fears?

Q2-4 Use Figure MFD-2 to walk the through four policies governments can use to eliminate a CA deficit (and perhaps generate a surplus). Hint: two of these policies involve shifts and two involve movements along the S&D curves in Figure MFD-1. Briefly list the advantages and disadvantages of each policy. Which are policies can be complementary? (hint: the 3 arrows of AbeEconomics). Are Figures MFD-1 and MFD-2 inconsistent?





In a small open economy like Mexico causality runs from $US inflows to the RER & CA balance. Unless the peso appreciates in real terms Mexico cannot invest more that it saves, if foreign investors want to invest in Mexico the peso RER must appreciate so Mexico can run a CA deficit. But what if there is a "sudden stop"?