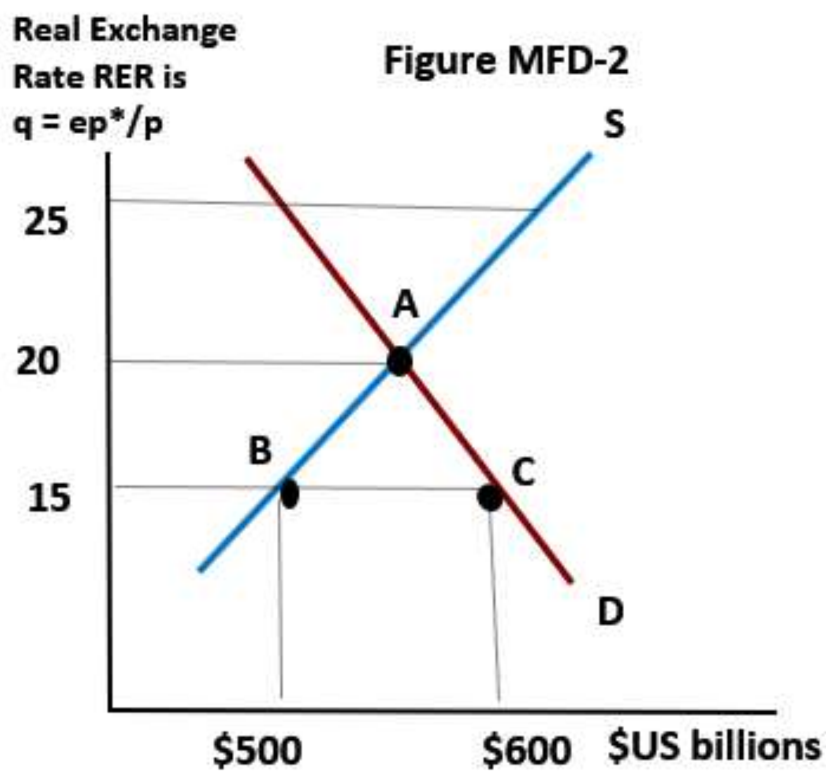
ECON 3235 Economics of Latin America **Quiz 3 Review Sheet v2** posted Oct 22nd 2018

Quiz 3 is scheduled for Thursday October 18th 2018 at 5pm Back to Course Calendar

See the lecture notes for Quiz 3: pdf or pptx

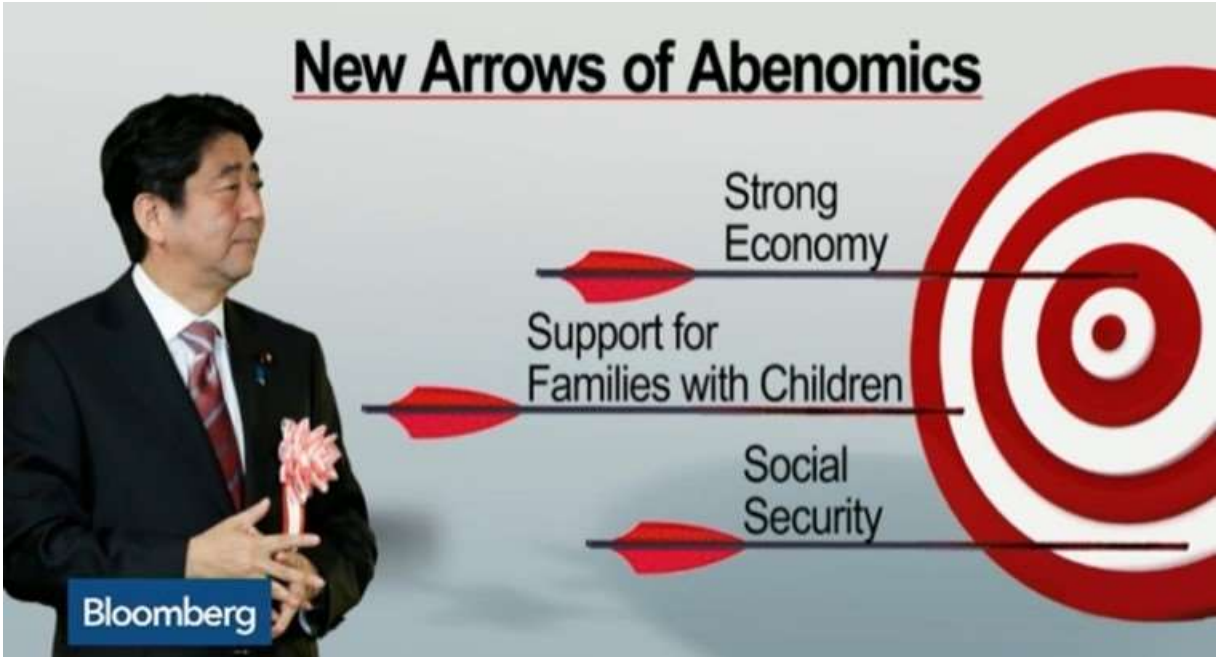
Q3-1 See the lecture notes (above) Use Figure MFD-2 to walk the through four policies governments can use to eliminate a CA deficit (and perhaps generate a surplus). Hint: two of these policies involve shifts and two involve movements along the MFD-2 S&D curves. Briefly discuss the advantages and disadvantages of each policy. Which policies can be complementary if a country wants to be a good neighbor (hint: why does Abeconomics have 3 arrows). Suppose a country uses devaluation (a rise in e) to move from trade deficit to surplus: what happens to its imports and exports, and how does this affect its trading partners? How does this illustrate an advantage small open economies have over large economies (the U.S. China, Germany or Japan).



Q3-2 What important dimension LatAm's world does Figure MFD-1 capture that MFD-2 does not? Why have SWFs become and important part of Chile's response under two Presidents? (formerly the Copper Stabilization Fund, now the Economic and Social Stabilization fund, why does this name change matter?)

Q3-3 The Three arrows of Abeconomics[1/] are mix of new external adjustment policies meant to restart the Japanese economy referred to with combination of good neighbor (and bad neighbor policies). That said the new "Arrows of Abeconomics" refer to goals not tools Why is this important (see the SWF name change discussed in Q3-2 above)

Q3-4 Start with Figure MFD-1 for a resource exporter, assume the economy starts a point A on a "normal commodity price" supply curve. Now add a high commodity (copper?) price curve crossing DD below point A and "low commodity price" (low CP) supply curve DD crossing above point A. MFD-2 ***now has three supply*** curves (2 added by you). Now suppose the RER stays at 15, what would happen to capital flows with a high and low CP supply curve? 15 (here we assume the economy started at point A, with no capital inflows…)



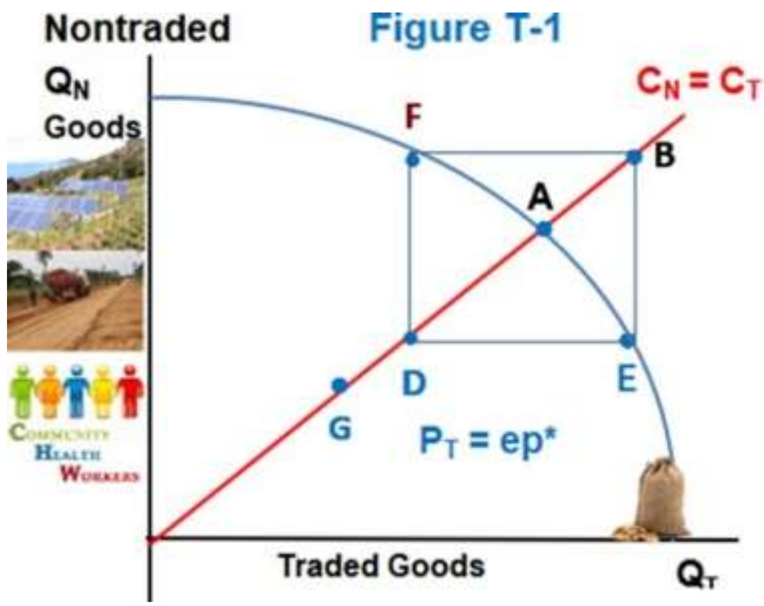
Source a Bloomberg video when newly relected PM Abe refocused on stabilizing population not just on devaluing the yen and ending deflation… After becoming only the first PM to be relected in 2012 since 1948, Shinzo Abe was elected leader of the ruling Liberal Democratic again on September 20th 2018 putting him on track to become Japan's longest serving Prime Minister…

1/ As Trading Floor.com points out "Few people, however, seem to know why the stimulus plan was named "Three Arrows". The name, in fact, is ancient and derives from a legend attributed to Motonari (1497–1571) – a powerful feudal lord from the West Chogoku region of Japan. Motonari had three sons – Mori Takamoto, Kikkawa Motoharu, and Kobayakawa Takakage – who he encouraged to work together for the benefit of the Mori clan. He is said to have handed each of his sons an arrow and asked them to snap it. After each snapped his arrow, Motonari produced three arrows and asked his sons to snap all three at once. When they were unable to do so (according to a legend still taught today), Motonari's point was that one arrow could be broken easily, but three bundled arrows could not.

Review Questions for Quiz 2

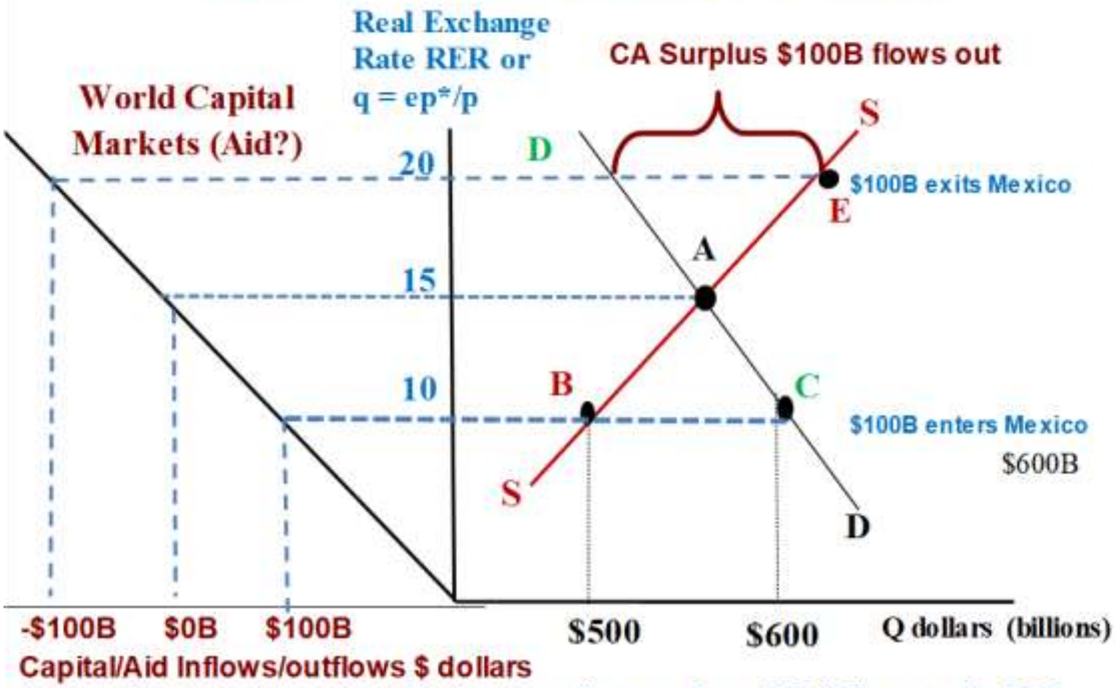
Q2-1 Use Figure T-1 to discuss the effect of capital inflows on the real exchange rate. Recall that $q = P_T/P_N$ Where $P_T = ep^*$ and now $P_N = p$ (domestic prices). Remember that in this model is the **TB = Q_T - C_T.** Capital inflows example: suppose consumers try to consume at B, how is this 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?

Figure MFD-1 Market for dollars in Mexico



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"?