1) In 1961, Germany faced the dilemma of an external surplus and a booming economy. As a result, speculative capital flowed into Germany and the Germans felt obligated to revalue their currency (rather than devalue it). Can you describe how such a “revaluation crisis” or “inflow attack” might operate when the government (like Germany’s at the time) is highly fearful of inflation? The reasoning is different from that underlying a devaluation crisis, because interest rates are pushed down by speculators and there is no danger of running out of foreign reserves. (Hungary in January 2003 is another example of an inflow attack).

2) Imagine that you are an economic advisor to the government of China. The country has a current account surplus and is facing gathering inflationary pressures.
   a. Show the location of the Chinese economy on a “4-zones of economic discomfort” diagram
   b. What would be your advice on how the authorities should move the renminbi’s exchange rate?
   c. What would be your advice about fiscal policy? In that regard, you have 2 pieces of data. First, the current account surplus is big, in excess of 5% of GDP for 2009 (though the surplus has declined; it was 11% of GDP in 2007 and 9% of GDP in 2008). Second, China provides a rather low level of government services to its people.

3) Assume that domestic (U.S.) and foreign bonds are imperfect substitutes and that investors suddenly shift their demand toward foreign bonds (away from U.S. Treasury Securities), raising the risk premium on domestic assets. Which exchange rate regime minimizes the effect on output, fixed or floating?

4) Imagine that the EMS had become a monetary union with a single currency but that it created no European Central Bank to manage this currency. Instead, imagine that the task had been left to the various national central banks, each of which was allowed to issue as much of the European currency as it liked and to conduct open-market operations. What problems can you see arising from such a scheme?

5) If you look on the website of the Bureau of Economic Analysis, you will see that between the end of 2003 and the end of 2007, the net foreign debt of the U.S. rose by far less than the sum of its current account deficits over those years. At the same time, the dollar depreciated. What is the connection?