Question 1. True/False: Bretton Woods/EMS (40 points)

For this question, write no more than one paragraph for each question. Is each of the following statements true or false? Explain your answer.

   i) Under the Bretton Woods monetary system, an increase in world gold production - perhaps due to new gold discoveries - relative to the production of all other goods might have required that all currencies be revalued relative to gold to restore credibility to the fixed exchange rate system.

   ii) Under the Bretton Woods monetary system, a persistent balance of payments deficit for the US would have caused the gold reserves of the Fed. to fall while the dollar reserves of all other central banks would rise.

   iii) Restrictive monetary policy conducted by the Bundesbank tends to reduce the DM price of an ecu.

   iv) If the pound sterling reaches its upper margin price against the French franc, then the Bank of England must intervene in the foreign exchange market by selling ecu reserves and purchasing pounds while the Bank of France must buy ecu reserves and sell pounds.

   v) Bretton Woods and the EMS are identical international monetary systems in which gold has simply been replaced by the ecu as the relevant reserve asset.

Question 2. International Money and Capital Markets (60 points)

   i) Answer questions #1 and #2 at the end of Chapter 4.

   ii) Answer questions #1, #2, #3, and #5 at the end of Chapter 5.

   iii) Expected inflation differentials cause interest rate changes, which in turn bring about exchange rate changes. Is this statement true or false? Explain.

   iv) Provide four reasons why although interest arbitrage may not hold exactly, we cannot exploit arbitrage to make profits.