Exercise 3:   Long-term implications on exchange rates of repeated macroeconomic policy intervention
Capital outflows from a speculative panic situation under a fixed or a flexible exchange regime

Objective: This exercise is designed to have the student use simple models developed in class and through the readings to explain real-world phenomena related to the longer-term implications of macroeconomic policy intervention, its relation to changing expectations, risk and uncertainty and speculative panic situations.

Assignment: In this case, you are to consider the long-term effects of repeated macroeconomic policy intervention on the macroeconomy. Let the long-term reflect a multi-period expansionary policy shift (i.e., that the government runs a *persistent* budget deficit). In effect, the long run is to be considered as the policy implications over the course of several years (within which the relevant macroeconomic variables or expectations have enough time to adjust to the policy changes). Keep in mind the results obtained from exercise 2 (i.e., for period 1). Make whatever assumptions you want over capital mobility and the exchange rate regime to consider what the likely outcome of repeating the policy over the longer term.

3.1 To help you think through the implications of the repeated policy intervention, set up a chart as provided below to think through the direction and magnitude of the changes in the variables. Make your assumptions explicit. What is the likely outcome of such a repeated intervention? Describe in detail, if you can, the scenario that led up to this outcome. Try and complete the table before class.

| Period | (G-T) | $(S^P - I)$ | BOP situation | | | $E_{lc/fc}$ | i | Y | P | Other |
			BOT	Net K-flows	ΔR					
1	(G-T)>0									
2										
3										

3.2 Provide a model, using the Mundell-Fleming framework (IS-LM-BP, AA-DD, and/or the asset market-money market models) to demonstrate the effects of the outcome you sketched out in the chart above. Explain your assumptions.