**SØK 2009, fall 2017**

**Candidate 10014, grade A**

Question 1

1. Discuss factors that influence the expected exchange rate in the long run
2. Analyze how a shift in the expected exchange rate influences the exchange rate
3. Discuss instability of the exchange rate as the result of ‘overshooting’

Question 2

1. The existence of asymmetric shocks between countries creates adjustment problems in a monetary union. Show how asymmetric demand and supply shocks affect macroeconomic adjustment in a two-country model.
2. Analyze how adjustment mechanisms in a monetary union can reduce the macroeconomic effects of shocks and contribute to macroeconomic balance.
3. Discuss how a government can counterbalance negative shocks inside and outside a monetary union.

Let me start with some broad background about exams in general. We want to check the knowledge and understanding of the students. But most students don’t show much of themselves – they often reproduce lecture notes and textbook stuff relevant for the questions. ‘Everything I know about this issue’. Only the best students address and answer the questions and structure their text so that it can be read as an independent investigation.

Question 1 shows the case in point. Only very few students started out with sub-question a) and the long run factors forming the basis for present exchange rate expectations. Candidate 10014 is among the few and offers a short and to the point clarification of purchasing power parity and real exchange rate in the first pages. The candidate should have written more about expectations. The presentation of the basic foreign exchange market model captures the essentials and derives the key results in sub-question b). Overshooting in sub-question c) is best explained by allowing changing money supply to affect exchange rate expectations. This is well explained and understood, and the dynamic paths of the variables are shown.

In question 2 the candidate presents a compact form of the standard aggregate demand – aggregate supply model to discuss asymmetric shocks. The basic asymmetric demand and supply shock asked for in sub-question a) are presented in diagrams and well done. The adjustment mechanisms are discussed in sub-question b) emphasizing labor mobility and wage flexibility. Again well understood. Then various policy responses are derived in sub-question c) and cover transfers, fiscal policy, and even supply side policies.

As you can learn from this candidate, grade A can be achieved in a fairly short answer when your text concentrates on the questions raised, you are in control of the most important analytical tools of the field, and you have a good understanding of the issues and policies discussed.

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