Regrade policy: If you would like your test regraded, please submit a written statement to explain why. Your entire test will be regraded, so there is a possibility that points could be lost not gained. All regrade requests must be submitted within one week of exams first being returned.

Multiple Choice:
Version A  1) a  2) d  3) b  4) d  5) c  6) a
Version B  1) b  2) a  3) d  4) c  5) d  6) b
Version C  1) c  2) e  3) a  4) b  5) a  6) c

Parity Conditions:
Version A  7) b  8) d  9) c  10) a  11) d  12) b
Version B  7) d  8) b  9) b  10) d  11) c  12) a
Version C  7) c  8) a  9) d  10) b  11) b  12) d

Monetary Approach:
\[% \Delta E_{\text{US/EU}} = \pi_{\text{US}} - \pi_{\text{EU}} = (\mu_{\text{US}} - \mu_{\text{EU}}) - (g_{\text{US}} - g_{\text{EU}})\]

To be consistent with the monetary approach equation, it must be that money demand rises in the U.S. relative to Europe, and this must be larger in percentage terms than the relative rise in U.S. money supply compared to Europe. This rise in money demand could be due to the faster rise in income in the U.S., which is true given that Europe has shrinking GDP again while the U.S. is growing. (Theoretically, it could also be due to lower interest rates in the U.S. reflecting lower inflation expectations for the future. I don’t think this actually relevant to the U.S. case in reality, but it would be an acceptable theoretical answer here.) If relative U.S. money demand is rising faster than relative U.S. money supply, then current inflation should be lower in the U.S. than in Europe.

Overshooting:
a) The graph is the same as in lecture 3 slide 43.
b)