

Quiz 2: *Use both graphs and a short written explanation to answer each of the questions below. Be clear and precise. Answer below, and on back of page if necessary.*

1. Using both the E-R-M and the AA-DD diagrams, show how an unexpected devaluation in the price of foreign exchange would affect interest rates, the money supply, the current account balance, and output.
2. Using both diagrams, now show how the expectation of a devaluation in E would affect the economy, and explain how the expectation can create a self-fulfilling prophecy.
3. Explain the basic rules of the Bretton Woods system, and why it created an asymmetry for the resolution of U.S. balance of payments.