# Exchange Rates and Macroeconomic Policy

Fill in the following chart to help you make the connections between exchange rates and monetary and fiscal policy.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Expansionary Monetary Policy** | **Contractionary Monetary Policy** | **Expansionary Fiscal Policy** | **Contractionary Fiscal Policy** |
| **What policy tools might be used?** |  |  |  |  |
| **What happens to interest rates (real or nominal)? Explain.** |  |  |  |  |
| **What happens to AD? Explain.** |  |  |  |  |
| **What happens to international value of the**  **U.S. dollar? Explain** |  |  |  |  |
| **What happens to Net Exports? Explain.** |  |  |  |  |

# Exchange Rates and Macroeconomic Policy Answer Key

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Expansionary Monetary Policy** | **Contractionary Monetary Policy** | **Expansionary Fiscal Policy** | **Contractionary Fiscal Policy** |
| **What policy tools might be used?** | *Buy bonds*  *Lower reserve ratio Lower discount rate* | *Sell bonds*  *Raise reserve ratio Raise discount rate* | *Increase government spending*  *Decrease taxes* | *Decrease government spending*  *Increase taxes* |
| **What happens to interest rates (real or nominal)? Explain.** | *Nominal interest rates decrease because the money supply increases.* | *Nominal interest rates increase because the money supply decreases.* | *Real interest rates increase because the demand by government for loanable funds increases.* | *Real interest rates decrease because the demand by government for loanable funds decreases.* |
| **What happens to AD? Explain.** | *AD increases because private investment spending and interest sensitive consumer spending increases.* | *AD decreases because private investment spending and interest sensitive consumer spending decreases.* | *AD increases because government spending increases or consumer spending increases due to an increase in disposable*  *income.* | *AD decreases because government spending decreases or consumer spending decreases due to an decrease in disposable*  *income.* |
| **What happens to international value of the**  **U.S. dollar based on change in interest rates? Explain** | *The U.S. dollar depreciates because there is lower demand for U.S. financial assets due to lower interest rates.* | *The U.S. dollar appreciates because there is higher demand for U.S. financial assets due to higher interest rates.* | *The U.S. dollar appreciates causing higher demand for*  *U.S. financial assets due to the higher interest rates.* | *The U.S. dollar depreciates causing lower demand for*  *U.S. financial assets due to the lower interest rates* |
| **What happens to Net Exports based on the changing value of the dollar? Explain.** | *When the dollar depreciates, exports increase because they are less expensive for foreigners to buy causing net exports will increase.* | *When the dollar appreciates, exports decrease because they are now more expensive for foreigners to buy causing net exports will decrease.* | *When the dollar appreciates, exports decrease because they are now more expensive for foreigners to buy causing net exports will decrease.* | *When the dollar depreciates, exports increase because they are now cheaper for foreigners to buy causing net exports will increase.* |