

**This homework is due on Thursday September 10 at the end of class**

**Please answer each question on a separate sheet; write your name and PSU ID on each sheet of paper you turn in.**

**The homework consists of 3 questions**

**Question 1: (20 points)**

- i) Do part (1) to (6) of exercise 1 at the end of Chapter 1 in the lecture notes.
- ii) Define what is a stock variable; Define what is a flow variable; Give an example of a stock variable and a flow variable that are related to each other. How the evolution over time of the stock variable is affected by the evolution of the flow variable? (hint: think about the net foreign asset position of a country and the current account balance abstracting from valuation effect)
- iii) Consider the following example. There are two countries in the world: country A and B. On Dec 31 2012:

- Residents in country A own one share of a firm in country B. The share is worth 100 \$ and it allows to receive dividends paid by the firm in country B;

- Residents in country B owns a bond issued by residents in country A. The bond is valued at 100 \$ and it will pay an interest rate of 5\$ on March 1 2013;

Between January 1st 2013 and December 31st 2013:

- Country A accumulates a trade balance deficit of 50\$ (and therefore country B accumulates a trade balance surplus of 50\$); The deficit is paid by country A residents issuing bonds to country B residents for 50\$

- On March 1 2013 the residents in country A pay the 5\$ interests on the bond owned by country B residents; the residents in country A pay for the interest payments by issuing a bond to country B residents for 5\$

- On September 1 2013 the firm in country B pays a 5\$ dividend per each share (recall that residents in country A own 1 share of such firm); the firm in country B pays for the dividends by issuing a bond to country A residents for 5\$

*(it continues on the next page)*

On December 31 2013:

- The bond initially owned by residents in country A is still worth 100\$
- The stock market crashes: the value of the share of country B firm owned by country A residents is now worth only 80\$

Please write down the balance of payments account (both current account and financial account) for the year 2013 (for the current account it should look like Table 1.1 in the notes) for country A and B.

Please write down the net international investment position of country A and country B on Dec 31 2012 and Dec 31 2013. What is the gross position (assets and liabilities) on December 31 2013?

Please explain how the current account balance is related to the change in net international investment position.

**Question 2: (40 points)**

Do exercise 2 at the end of Chapter 1 in the lecture notes

**Question 3: (40 points)**

Do exercise 3 at the end of Chapter 1 in the lecture notes.

*NOTE: For question 2 and 3 you need to download the data set on net foreign asset positions constructed by Lane and Milesi-Ferretti. There seems to a problem downloading it from a PSU computer so I posted the excel file on ANGEL. You can download it from there without problem.*