3

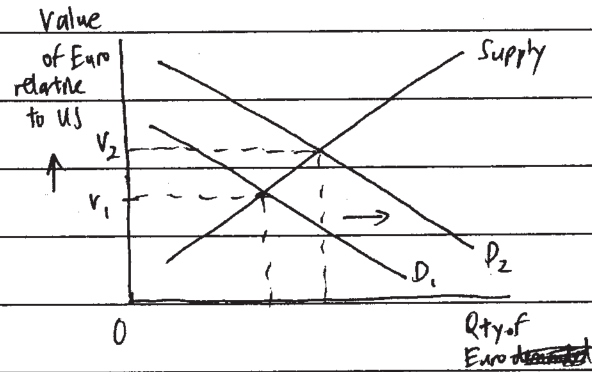
Write in the box the number of the question you are answering on this page as it is designated in the exam.

3A

3 a)(i) United States will experience an outward flow of financial capital to the European Union (EU)

This occurs as businesses will find it more profitable to buy European Union financial assets as they can receive a higher real interest rate (4.5%) ~~in the~~ as compared to the United States, which has a lower real interest rate of 3.75%.

(ii)



The value of the euro will appreciate relative to the United States dollar from V_1 to V_2 in a flexible exchange rate system.

b) European Union's net exports will ~~falls~~ decrease.

Net exports in EU = Exports − Imports

Since an appreciation in the value of the euro will result in ~~the~~ the increase in prices of European Union products internationally, demand for EU products will fall both domestically and internationally. Since this also makes imports relatively cheaper, the quantity of imports demanded will increase. Thus it can be concluded from the above equation that EU's net exports will ~~falls~~ decrease.