Problem Set 9
(due in class on Tuesday, November 4)

1. Chose a country other than the United States and answer the following questions:

   a. Try your hands at testing the law of one price. Chose at least one good which is sold
      in “your” country and the U.S., and examine if the law of one price holds. You may
      want to use the internet to look for prices of goods in different countries. For example,
      you may want to look at prices of identical books, CDs or DVDs at www.amazon.com,
      etc. You may find prices through other sources as well, such as personal visit, study abroad
      experience, friends or relatives, foreign newspapers or magazines, mail order catalogs, etc.

   b. Based on the example given in part a) would you characterize your country’s real exchange
      rate as over- or under-valued?

   c. Calculate the aggregate real exchange rate index for your country with respect to the
      United States. Use annual statistics for the past 3 or more years. (You may use IFS as
      the source of your exchange rate and price level data. Click on the Adobe icon to get the
      pdf version of the tables.) The U.S. CPI for the past 8 years is in the following table:

      \[
      \begin{array}{cccccccc}
      CPI_{US}^{base=2000} & 100 & 102.8 & 104.5 & 106.8 & 109.7 & 113.4 & 117.1 & 120.4 \\
      \end{array}
      \]

   d. Based on the data you found in the previous question, does relative PPP hold?

   e. Has the relative price of U.S. goods gone up or down (i.e. has the U.S. real exchange rate
      appreciated or depreciated) in 2007?

   f. What is your prediction for the nominal exchange rate in the near future? This question
      is your opportunity to comment on your findings in parts a) through e).