Q.34

In 2022, fluctuations in the exchange rate of the Japanese yen (JPY) against the US dollar (USD) and Japan's monetary policy raised huge concerns.

Source A: Exchange rate of USD against JPY between 3 January 2022 and 3 October 2022

(Source: Federal Reserve Bank of St. Louis)

Source B: A news excerpt about Japan's recent monetary policy

After a monetary policy meeting held on 22 September 2022, the Bank of Japan (the central bank of Japan) announced that it would continue expanding the monetary base until the year-on-year rate of increase in the Consumer Price Index (all items less fresh food) exceeds 2%. Also, the Bank of Japan would continue to purchase Japanese government bonds.

(Source: various newspapers)

Source C: A news excerpt about a foreign exchange intervention by the Ministry of Finance Japan

On 22 September 2022, the Japanese government bought Japanese yen and sold US dollars in the foreign exchange market, which was the first yen-buying intervention in 24 years. The Japanese yen immediately jumped from about JPY 146 to about JPY 141 against the US dollar. It is reported that Japan used part of its foreign exchange reserves for the foreign exchange intervention.

(Source: various newspapers)

Source D: Some views on the change in the exchange rate of the Japanese yen

A forex trader	The United States has adopted a tightening monetary policy while Japan has adopted an easing monetary policy. The monetary policy stances of the two countries are different. The Japanese yen would depreciate against the US dollar.
An electrical appliance manufacturer in Japan	My firm has benefited from the depreciation of the Japanese yen. Orders from other countries have increased significantly. I am increasing production.
A western restaurant owner in Japan	The import price of ingredients has increased sharply due to the depreciation of the Japanese yen. The cost of operating my restaurant has increased a lot.
A university professor working in Japan	I exchange part of my salary for USD 5,000 every month and remit it to my children in the United States. If the Japanese yen continues to depreciate, I will consider looking for work in other countries.

Questions

(a) Refer to Source A. Assume the prices of goods produced in the US (in terms of USD) have remained unchanged. With the aid of a diagram, explain how the change in the exchange rate would affect the total value of US exports to Japan (in terms of USD). (8 marks)

(b) In terms of the quantity theory of money, explain under what condition the monetary policy mentioned in Source B can achieve its inflation target. (4 marks)

(c) Refer to Source C. Explain whether the foreign exchange intervention helps the Japanese government achieve its inflation target. (3 marks)

(d) Explain the function of price illustrated by the remark of the Japanese electrical appliance manufacturer in Source D. (2 marks)

(e) To which type of price elasticity of demand does the university professor's demand for the US dollar in Source D belong? Explain. (2 marks)

For part (f), candidates are required to present their answer in essay form. Criteria for marking will include use of sources and economic theories, relevant content, logical presentation and clarity of expression.

(f) With reference to the above sources and your own knowledge in Economics, discuss the effects of an open market purchase of government bonds on Japan, including:
- the general price level,
- balance of payments, and
- other economic variable(s).

(14 marks)

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