Practice Problems: Sudden Stops
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1. What is a sudden stop and why might it occur? Is it a problem for developed or emerging markets? Why are they usually part of "twin crises"? Explain.

2. Suppose a country's current account is in deficit. Suddenly international lenders stop lending them funds.
   a. Which account in the balance of payments is hit first?
   b. Link the balance of payments identity to the national income identity to discuss what must happen as a result of the sudden stop.
   c. Can't a country just use its international reserves to offset the sudden stop? Explain.

3. Consider a country that suffers a sudden stop.
   a. Use an Aggregate Supply – Aggregate Demand diagram to show what happens to the price level in the short run.
   b. If wages are relatively slow to adjust, what happens to the real wage in the short run and what are the implications of this (in terms of AS-AD and labor markets)?
   c. Using all the above, discuss whether the effects of the sudden stop will be short term or longer term.

4. Consider a country that suffers a sudden stop.
   a. Use an Aggregate Supply – Aggregate Demand diagram to show what happens to the economy in the short run. (Same answer as #2 (a)).
   b. Using the AS-AD diagram, discuss what policy options are normally available during a recession?
   c. Which policies might not be feasible during a sudden stop episode? Explain.

5. During a sudden stop, domestic interest rates are usually high.
   a. Explain why this might happen.
   b. If the central bank tries using international reserves to ease the pain of the sudden stop, what would this do to nominal interest rates? (Hint: use a money market diagram). Is this a short – or long-run effect on nominal interest rates?
   c. Given what you know about sudden stops and the loanable funds market, what predictions might you make for real interest rates in a crisis country? Would this have a short – or long-run effect on the economy?

6. Recall that the real exchange rate is defined as the price of traded goods over the price of home goods (i.e., $\varepsilon \equiv P^T / P^H$).
   a. For the same percentage fall in demand for home and traded goods, what happens to the real exchange rate in small open economies? Explain.
   b. How might this relative price swing affect the traded and home good sectors of the economy? Explain.

7. Discuss why the maturity structure of a country's debt might matter for a sudden stop.