

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to follow these directions will cost you 1 point on the assignment and failure to type it will cost you 10 points.

1) (25 points each) Illustrate the following events on the IS/LM/BP diagram with a flexible exchange rate. Explain why the curve(s) moved as drawn.

A) The government spends more with the LM line steeper than BP line.

B) The economy starts with high unemployment and moves by itself to full employment.

Assume the LM line is flatter than the BP line.

C) The foreign interest rates increase. Use a very steep BP line.

2) (25 points) Explain why the IB line slopes up on the policy mix diagram and is steeper than the EB line. Explain why the area up to the left of where the lines cross, has a surplus and unemployment.