

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) Figure 19.8 describes the movements of the IS/LM/BP diagram. However, the book does a poor job of explaining why the curves moved.

A) (15 points) For the left-hand panel, give the missing explanations as to why the curves moved. Also explain why the curve that is not moving do not move.

B) (15 points) For the right-hand panel, give the missing explanations as to why the curves moved. Also explain why the curve that is not moving do not move.

C) (15 points) Given the explanations in Parts A and B, what is the economic reason that the GDP is up with fixed exchange rate, but not with a flexible exchange rate?

2) (40 points) Draw the IS/LM/BP diagram with BP flatter than LM, and the SRAS/LRAS/AD diagram. Illustrate an increase in the foreign GDP on it assuming a fixed exchange rate. Explain why the curve(s) moved as drawn. How would it be different if it had been a flexible exchange rate? (No need to draw the diagrams for flexible exchange rate.)

3) (15 points) Why do economies with independent central banks have lower inflation rates?