

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. Failure to follow these directions will cost you 1 point on the assignment.

This assignment covers chapter 5.

1) (20 points) Use the 45° diagram (a.k.a. the Keynesian cross) with $C + I + G + NX$ (where NX is net exports) to show an increase in government spending. Given the diagram, estimate the size of the autonomous expenditure multiplier. Explain why the line moved as drawn and how you estimated the multiplier.

2) (30 points) If investment is sensitive to interest rates, then what does that mean about the IS/LM diagram? Why does it mean that? Draw the diagram in that manner and then show an increase in government spending. Why did the line(s) moved as drawn? Was government spending effective? Why or why not?

3) (30 points) If money demand is sensitive to GDP, then what does that mean about the IS/LM diagram? Why does it mean that? Draw the diagram in that manner and then show an increase in the money supply. Why did the line(s) moved as drawn? Was money supply increase effective? Why or why not?

4) (20 points) Use equations 5.25a through 5.25d on page 165 to derive the autonomous expenditure multiplier. Assume that R , G , and X are exogenous. Briefly explain what you did.