Wilf Csaplar Jr. Economics 488(365) Homework #7 Due Tuesday 3/25

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.

We will be meeting during my office hours on Thursday. Come by some time between 4:00 and 5:00pm to discuss the previous assignment and the material you are reading.

This assignment covers section 17.4 - through section 18.4. This assignment is due the Tuesday after break which will give you a chance to ask me questions on Monday. I will hand it back on Thursday, 3/27, in a short meeting at 4:00. It will be short because I will be leaving for a conference. Therefore, the test will be postponed until after the conference. It will be held Tuesday, 4/1, at 4:00. We will meet in my office. There will be an assignment due on that Friday, 4/4. The review sheet for the exam will be written and published on the web at some point early during break, most likely Monday, 3/17.

1) (15 points) Compare the formulas for k' and k". Which is bigger? What is the economic reason for that?

2) (15 points) Compare the formulas for k* and k**. Which is bigger? What is the economic reason for that?

3) (20 points) The Swan Diagram has the exchange rate as a function of domestic expenditures and vice versa. Explain why a point in Zone III in figure 18.1 is deficit and inflation. This is most easily done by first stating wether R is $/£ or £/$ and then stating what happens when you start at point J and move up or what happens if you start at point J' and move down.

4A) (35 points) This question is designed to help you learn something that I believe the book does not explain with sufficient clarity. Draw an economy in equilibrium on the IS/LM/BP diagram with the BP curve flatter than the LM curve. Now show an increase in government spending and explain why the curve moved as drawn. The economy will be at the intersection of IS and LM. At that point, is there a net outflow or inflow on the foreign exchange market? How can you tell? Assuming a fixed exchange rate, what will the government automatically be forced to do with the money supply to correct that problem? Why will they have to do that? Illustrate that monetary policy on the diagram. Explain why the curve moved as drawn.

4B) (15 points) Without drawing the diagram, how would your answer to part A differ if the BP line was steeper than the LM curve? Explain your logic.