

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (5 points) Explain $KFA = -CA$.

2) (15 points each) For each the following, determine what happens to the NX, CA, short-term KFA, and long term KFA. Explain your logic.

A) You buy \$5000 of stock in Samsung.

B) A Canadian buys \$500 worth of water bottles made in the USA.

C) A Mexican buys \$1000 worth of shares in Ford.

3) (25 points) Draw the S/I diagram for a small open economy with a KFA deficit. Explain how the diagram shows a KFA deficit. Illustrate the effects of a decrease in the world interest rate. Explain why the curve(s) moved as drawn. What happens to the level of saving, level of investment, and the KFA deficit?

4) (25 points) Draw the S/I diagram for a small open economy with a CA deficit. Explain how the diagram shows a CA deficit. Illustrate the effects of a decrease in government spending, assuming Ricardian Equivalence does not hold. Explain why the curve(s) moved as drawn. What happens to the interest rate, level of saving, level of investment, and the CA deficit?