Problem sets 4: Open economy macroeconomics

EE312: Intermediate macroeconomics

Semester 2/2018

Instructor: Dr. Kittichai Saelee

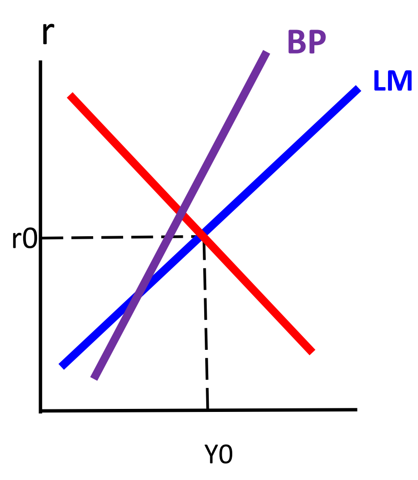
Due on Feb 28th ,2018 at the BE office. (before 3 pm)

1) Suppose we start from an external equilibrium (ro,yo) on a BP curve. Then, something happens in our economy. Discuss the "direct" impact of these following situations on the balance of payments, and the BP curve.

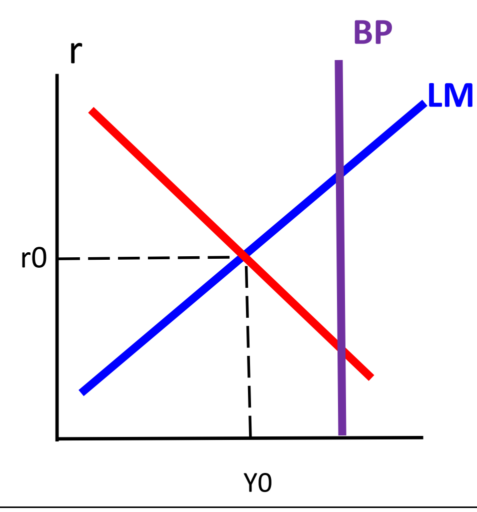
- 1.1) An autonomous fall in countries' demand for exports
- 1.2) An increase in the domestic interest rate
- 1.3) An expected appreciation in USD
- 1.4) Government cuts income tax
- 1.5) An increase in productivity growth of foreign trading partners

2) Consider two cases below. In each case, state out the type of disequilibrium. Then proceed with the discussion about the adjustment process towards the general equilibrium. Analyze the adjustment process under both flexible and fixed exchange rate systems.

Case 1

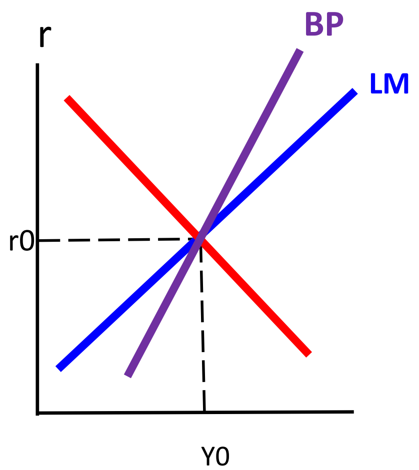


Case 2

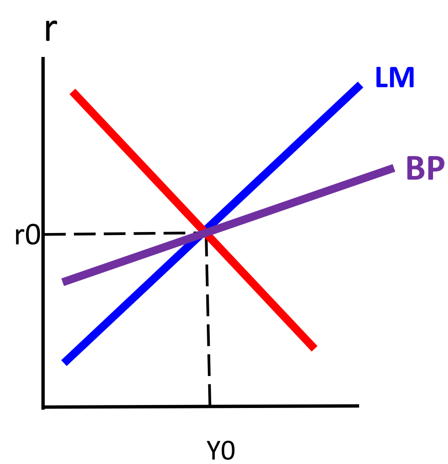


3) Suppose we start from a general equilibrium (ro,yo). Given the two possible cases below, discuss the effect of monetary expansion under both fixed and flexible exchange rate systems. Under the same exchange rate regime, does monetary expansion generate the same outcome to output, exchange rate and net exports. Provide some economic intuitions.

Case 1: BP is steeper than LM



Case 2: BP is flatter than LM



4. Using the Mundell-Fleming model (IS-LM-BP under perfect capital mobility) what will be the effects of the followings on aggregate income, trade balance, consumption and investment

4.1) A bust in stock market prices with fixed exchange rates

4.2) An decrease in ATM charges with floating exchange rates

4.3) An increase in money supply with fixed rates

4.4) A reduction in tax rate with floating exchange rates

5) In a floating exchange rate regime- to what extent does the effectiveness of fiscal policy depend on the degree of capital mobility?
(Hint: Analyze the effect of fiscal policy under two extreme cases: (i) when BP is vertical and (ii) when BP is a horizontal one.)