Question 4 This is good. ① ~~This is one of the best~~ I have read so far! ② Effective; concise. ③ some points should be improved to make a perfect essay.

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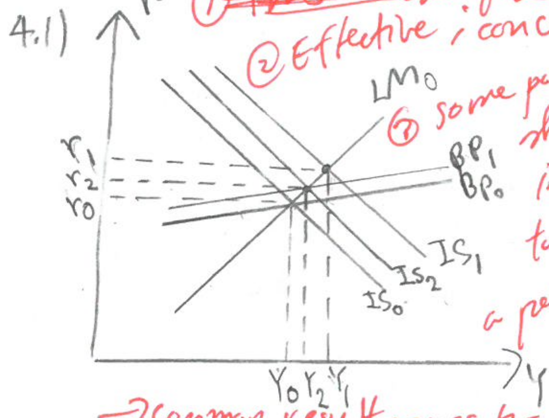
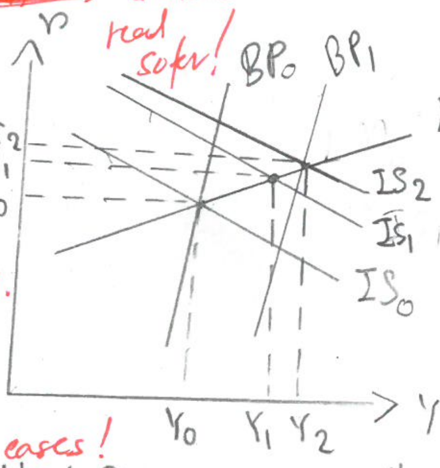




look at the strategy of this writing. Effective start from things that share in common then discuss cases.

→ common result across the remaining cases!

Cut in payrall income tax would left people with more disposible income to spend, IS_0 shifts to IS_1, Output increases to Y_1 with higher interest rates at r_1 due to higher money demand.

First, we analyze under the flexible exchange rate regime, then move to pegged exchange rate.

answer b/c BP As above the ~~BP~~.

If the BP curve is flatter than LM curve, then Y_1 and r_1 is going to be the point where there is balance of payments surplus. why?? need to explain; cannot just

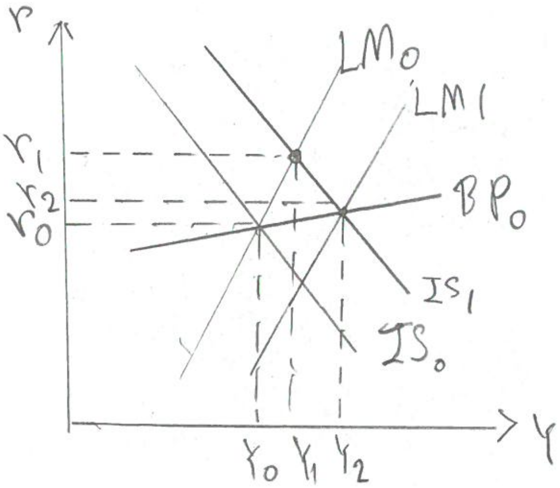
Excess supply for fx would drive the exchange rate down. Lower exchange rate makes imports cheaper and less exports, net exports decrease. IS shifts leftward to IS_2. BP also shifts leftward because now we must use higher interest rates at every level of Y to make BOP=0. good!

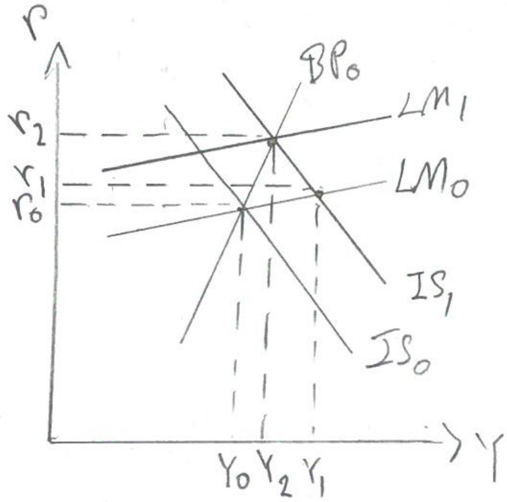
The final equilibrium is Y_2, r_2. good!! The "initial effect on Y" is reduced due to ~~lower exchange rates~~ appreciation in exchange rate which makes net exports smaller.

If the BP curve is steeper than LM curve then at Y_1, r_1 it would be the point that we have balance of payments deficit. the same comment as before

It implys excess demand in foreign exchange market, the exchange rate rise to clear the market. Higher exchange rate leads to higher net exports which shifts both BP and IS rightward. Y and r increase to Y_2 and r_2. The initial effect is amplified by higher exchange rate.

Now consider the impact under fixed exchange rate regime





When BP is flatter than LM and results in surplus in balance of payments at Y_1, r_1. To prevent the exchange rate from decreasing, the central bank must buy the excess supply of dollar which in turn increase money supply, LM_0 shifts to LM_1. The initial effect on Y is amplified by lower interest rates due to higher money supply, Y_1 increases to Y_2.

When BP is steeper than LM and leads to balance of payments deficit at Y_1 and r_1. To prevent the exchange rate from rising up, the central bank must sell dollar to the market which in turn reduces money supply and make the interest rates higher, LM curve shifts leftward to LM_1. The final equilibrium is Y_2, r_2. The initial effect is insulated by an increase in interest rates due to the attempt to peg the currency.

V. good