

Assignment 4 (OPTIONAL)

Total Marks: 50

Part A **True/ False/ Uncertain Questions** **20 Marks**

Explain why the following statements are True, False, or Uncertain according to economic principles. Use diagrams and / or numerical examples where appropriate. Unsupported answers will receive no marks. It is the explanation that is important.

A1. [10 Marks]

Both the temporary and permanent expansionary fiscal policy raises the current account balance. [Diagrams required]

A2. [10 marks]

Under a fixed exchange rate regime, the expectation of future devaluation leads to a balance of payments crisis. [Diagrams required]

Part B**Analytical Questions****30 Marks****B1. [10 marks]**

Imagine the economy is at a point on the AA-DD diagram which is below both the DD schedule and the AA schedule. Explain what will happen next.

B2. [20 marks]

Consider the model of output and exchange rate determination (the AA-DD model) we have studied in class. Suppose the economy begins at its long-run level with output at its full-employment level.

Compare and contrast the short-run effects of the temporary policies by the home government listed below on home output, the home current account, and the nominal exchange rate under a floating exchange rate regime to the effects on these variables under a fixed exchange rate regime.

Use AA-DD diagrams to support your answers.

- I.** A contraction in the home money supply.
- II.** An increase in taxes.
- III.** A revaluation of the home currency.
- IV.** A tariff on home imports.