HW 11: Due on Nov. 21st before class.

1. (Textbook, 7th e, chapter 11, question 6)

Use the IS-LM diagram to describe the short-run and long-run effects of the following changes on national income, the interest rate, the price level, consumption investment, and real money balances.

a. An increase in the money supply.
b. An increase in government spending.

2. (Textbook, 7th e, chapter 11, question 7)

The Fed is considering two alternative monetary policies:

- holding the money supply constant and letting the interest rate adjust, or
- adjusting the money supply to hold the interest rate constant.

In the IS-LM model, which policy will better stabilize output under the following conditions?

a. All shocks to the economy arise from exogenous changes in the demand for goods and services.
b. All shocks to the economy arise from exogenous changes in the demand for money.

3. (Textbook, 7th e, chapter 5, question 2)

Consider an economy described by the following equations:

\[
Y = C + I + G + NX, \quad Y = 5,000, G = 1,000, T = 1,000,
\]

\[
C = 250 + 0.75(Y - T),
\]

\[
I = 1,000 - 50r,
\]

\[
NX = 500 - 500\epsilon,
\]

\[
r = r^* = 5.
\]
a. In this economy, solve for national saving, investment, the trade balance, and the equilibrium exchange rate.

b. Suppose now that G rises to 1,250. Solve for the variables in question a. What do you find?

c. Now suppose that the world interest rate rises from 5 to 10 percent and G is still 1,000. Solve for the variables in question a. What do you find?

4. (Textbook, 7th ed, chapter 5, question 10)

“Traveling in Mexico is much cheaper now than it was ten years ago,” says a friend. “Ten years ago, a dollar bought 10 pesos; this year, a dollar buys 15 pesos.” Is your friend right or wrong? Given that total inflation over this was 25 percent in the US and 100 percent in Mexico, has it become more or less expensive to travel in Mexico?