Econ 3143 Macroeconomic Theory II
Assignment 3
(Chapter 16,17,18)

(Due on Nov. 27th, 2020)

1. Label each of the following statement true, false, or uncertain. Explain briefly.

a) Changes in current one year real interest rate are likely to have a much smaller effect than changes in expected future one-year real interest rate.

b) According to the IS-LM model, a fiscal contraction must lead to a fall in output, regardless of the effect of expectations.

c) If the dollar is expected to depreciate against the yen, UIRP implies that the US nominal interest rate will be greater than the Japanese nominal interest rate.

d) The only way a country can eliminate its trade deficit is through a real depreciation.

e) Other things equal, the interest parity condition implies that domestic currency will depreciate in response to an increase in expected exchange rate.

f) Countries with current account deficit must receive capital inflows.

g) If the Japanese nominal interest rate is equal to 0, foreigners will not hold Japanese bonds.

2. For each of the changes in **expectations** in a) to d), determine whether there is a shift in IS curve, LM curve, or both , or neither. In each case, assume that the expected current and future inflation rate equal to zero and no other exogenous variables are changing. (for Chapter 16)

a) a decrease in expected future real interest rate;
b) an increase in expected future taxes
c) a decrease of the current nominal interest rate;

3. 7th edition, Question 2 of Chapter 17 in the textbook. (Consider two fictional economies….)

4. 7th edition, Question 7 of Chapter 17 in the textbook. (Retrieve the most recent WEO and find the Balances on Current Account).

5. Suppose a country's output is below the policy makers' desired level of output and is experiencing a trade surplus. Assume that the policy makers' goals are to achieve the desired level of output (i.e., natural level of output) and balanced trade. Suppose we do not consider the impact of expectations, answer the following questions. (Hint: using the ZZ and NX curves)

a) Is it possible to use fiscal policy to achieve these two goals simultaneously? What kind of fiscal policy you should use. Explain.
b) If a fiscal policy cannot achieve the two goals simultaneously, what type of exchange rate and fiscal policy mix can be used? Discuss.
c) If an exchange rate policy is used, which curve will shift? How does this affect the fiscal policy in part a)?

6. 7th edition Question 7 of Chapter 18 in the textbook. (*Multipliers, Openness and fiscal policy*)

7. 7th edition, Question 8 of Chapter 18 in the textbook (Policy coordination and the world economy)

8. Read the focus box "Disappearance of Current Account Deficit in Europe Periphery Countries: Good News or Bad News?" and answer the following questions:
a) Why the current account deficit decrease in Europe periphery countries since 2008?
b) In the article, it is stated that "Given that these countries are members of the Euro area, they could not rely on an adjustment of the nominal exchange rate to become more competitive, at least vis-à-vis their Euro partners." Can you use the knowledge we learn to explain this sentence.
c)Explain the "import compression".