Macro Theory
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Problem Set 3

1. Application of the Neo-Classical Model to the U.S. economy
   a. The savings rate in the United States is low in comparison with that of other industrialized nations. If the U.S. were a closed economy, how would a low savings rate affect domestic (tangible) investment? How do governmental budget deficits affect investment?
   b. How would the results change if the U.S. is modeled as an open economy?

2. In 1994 and 1995, the Mexican Economy suffered under the pressure of foreign capital outflows. Assume that net export demand is negatively related to the real exchange rate and that all Model 1 assumptions hold including a positive responsiveness of savings to real interest rates and a negative responsiveness of investment to real interest rates.
   a. How would increased domestic (Mexican) savings affect net exports, the nominal exchange rate, the real exchange rate, and net capital flows to Mexico?
   b. How would reduced governmental expenditures affect net exports, the nominal exchange rate, the real exchange rate, and net capital flows to Mexico?
   c. How would increased U.S. purchases of Mexican goods affect the real exchange rate, the nominal exchanged rate, and net capital flows to Mexico?
   d. How would quotas on Mexican imports of U.S. goods affect net exports, the nominal exchange rate, the real exchange rate, and net capital flows to Mexico?

3. Use the data in the following table on Japan to answer the indicated questions.

Exchange rates in Yen / Currency unit

Percent of Trade	Country	1995	2000	2008
30%	United States (yen/$)	103	118	100
30%	China (Yen/ yuan)	12.4	14.2	14.3
40%	Europe (Yen/euro)	70	110	160

   a. Calculate the trade weighted exchange rate for each year relative to 1995.
   b. Based on the following data discuss how Japan's real exchange rate with the United States changed from 1995 to 2000 to 2008.

Country	Increase in Prices 1995 to 2000	Increase in Prices 2000 to 2008
Japan	2.5%	-1.8%
United States	13%	22%