Macro Theory
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Problem Set #6

1. Over the past several decades, investors around the world have become more willing to take advantage of opportunities in other countries; thus, economies are now more open than in the past. Consider how this development affects the ability of monetary policy to influence the economy.
    a. If investors become more willing to substitute foreign for domestic assets, what happens to the slope of the net cash outflow (and net export) curve (CF)?
    b. If the CF function changes as in part a, how does that affect the slope of the IS curve?
    c. Given the change in slope of the IS curve, how does this affect the central bank's ability to control interest rates? National income?

2. Suppose that policy makers in a large open economy want to raise the level of investment without changing aggregate income (Y) or the exchange rate (E).
    a. What combination of monetary and fiscal policy (if any) would allow this result to take place?
    b. When trade policy is added to the mix, would this change the answer to part a? If so, how?
    c. What combination of home country and foreign country monetary and fiscal policies could achieve the desired goal?

3. Use the Mundell-Fleming model to predict what would happen to aggregate income, the exchange rate, and the trade balance for **both** floating and fixed exchange rates in response to each of the shocks below. Be sure to include appropriate graphics.
    a. A fall in consumer confidence induces reduced household consumption (and increased household savings).
    b. Introduction of a stylish, affordable, electric car from China makes some consumer switch from domestic to foreign car purchases.
    c. Increased automated banking and payment systems reduce the demand for money.