Masters Macroeconomics — Fall 2015

Short Questions #8 — Due: 25 November

1. In a small open economy with perfect capital mobility, what would happen if the domestic interest rate were to exceed the world rate (would capital flow in or out)? How would this affect the country's exchange rate?

2. In Chapter 13, Mankiw writes the *NX* function as depending on the nominal exchange rate e. In Chapter 6, he wrote it as depending on the real exchange rate ε. Which is correct and why? Given that we are assuming that the price level is fixed, would the analysis of the IS^* and LM^* curves be any different using ε in place of e? Explain.

3. What effect does fiscal policy have on output in a small open economy with perfect capital mobility and a fixed exchange rate? Why? What effect does monetary policy have on output? Why?

4. What effect does fiscal policy have on output in a small open economy with perfect capital mobility and a floating exchange rate? Why? What effect does monetary policy have on output? Why?