ECON 329
Spring 2009

Homework 6

Due via email by 8:00pm on Sunday May 17

1. Exogenous variables
   List all of the exogenous variables in the IS-LM-FX model.

2. Shifting the curves.

a. List everything you can think of that would cause the IS curve to shift to the right.
b. List everything you can think of that would cause the LM curve to shift to the right.

3. Using the IS-LM-FX model
   In each of the following scenarios, tell me what (if anything) would happen to
   Y, i, C, I, TB, the government's budget surplus/deficit, E.
   Assume flexible exchange rates unless otherwise specified.
   All I require you to write for each part is something like "Y rises, i falls, C rises, I rises, TB falls, the budget deficit rises, E falls."
   However, to practice for the final exam, I urge you to draw the diagrams and work through the analysis for each of the following scenarios. (But do not include this work with your homework submission.)
   Here are the scenarios:

a. Businesses lower their forecasts of future GDP and, as a result, reduce their investment expenditure.
b. Homeowners see their net worth fall as house prices fall, and, as a result, reduce consumption.
c. Expansionary fiscal and monetary policy in Europe increases incomes in all European countries.

4. Picking the right mix of fiscal and monetary policy
   Monetary and fiscal policy affect output by affecting the aggregate demand for goods and services. Policy is expansionary if it increases aggregate demand. Expansionary fiscal policy involves either increasing G, reducing T, or a combination of the two. Expansionary monetary policy involves increasing the money supply. Policy is contractionary if it reduces aggregate demand. Contractionary fiscal policy involves reducing G, increasing T, or a combination of the two. Contractionary monetary policy involves reducing M.
   Tell me which policy or mix of policies would be most likely to achieve the goals described in each part of this question. Briefly explain your answer. Assume flexible exchange rates unless otherwise specified.

a. Goals: raise output and reduce the trade deficit
b. Goals: raise output while keeping the exchange rate unchanged
c. Goals: keep output constant in the face of a drop in foreign income (and hence drop in foreign demand for home country exports)
d. Goals: boost output while keeping investment constant at its initial level
e. Goals: maintain a fixed exchange rate in the face of a negative shock to investment