

ECON 463
Quiz 3

Assume that there are two countries, Home and Foreign. Both countries trade with each other; Home's exports to Foreign are a positive function of the price of Foreign's currency, and Home's imports from Foreign are a function of its own income. The same relationships apply, of course, for Foreign.

- A. Using the AA-DD model, show the effects on Y and E of an increase in the Home country's money supply under fixed exchange rates. Then show the effect of this policy in the HH-FF model, assuming both central banks take responsibility for maintaining fixed exchange rates, and explain why your answer may differ from the single-country case.
- B. Using the AA-DD model, show the effects on Y and E of a permanent increase in the Home country's money supply under floating exchange rates. Then show this effect of this policy in the HH-FF model, and explain why your answer may differ from the single-country case.