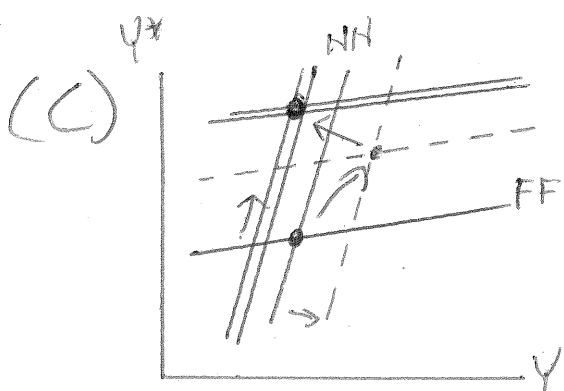
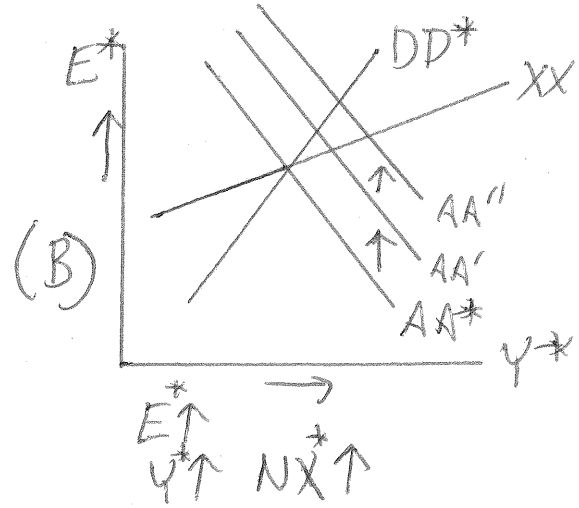
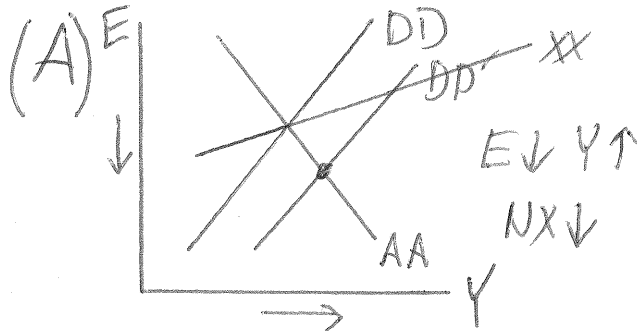


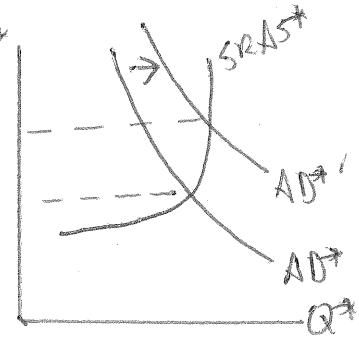
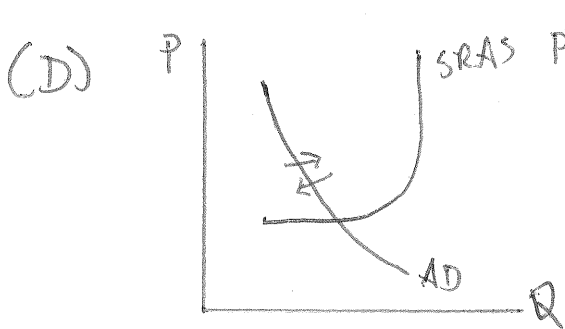
Assume that there are two countries, Home and Foreign. Both countries trade with each other; Home's exports to Foreign are a positive function of the price of Foreign's currency, and Home's imports from Foreign are a function of Home's own income. The same relationships apply, of course, for Foreign,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

- Using the AA-DD model for Home, show the effects on Y and E of a temporary tax cut. Adding an XX curve, show how this affects Home's net exports with Foreign.
- Using the AA-DD model for Foreign, show the effects on Y^* and E^* of a permanent increase in Foreign's money supply. Adding an XX curve, show how this affects Foreign's net exports with Home.
- Using the HH-FF diagram, show how (A) and (B) together would affect aggregate demand in both Home and Foreign. Include the separate effect of exchange rate adjustment.
- If the Home country was in a recession but the Foreign country was not, how would (C) affect inflation in both countries? Show this on two AD-SRAS diagrams for Home and Foreign.

5 points each



The initial policies make $NH \rightarrow, FF \uparrow$.
 But $E \downarrow$ makes $HH \leftarrow, FF \uparrow$.
 Little effect on Y , Big effect on Y^*



Ironically, little positive impact at Home, but price inflation in Foreign.