1. Use the ISLM-FX diagram to show equilibrium in the product market, money market, and foreign exchange market for the Home country. Label your graphs, and use solid lines. Give the equations for each. Then suppose the Home country imposes a tariff that significantly reduces its imports. How would that affect the current account? Using dashed lines for any shifted curves, show how this would affect the interest rate ($i$), gross national disposable income ($Y$), and the direct forex rate ($E$).

![ISLM-FX Diagram]

IS equation: \[ Y = C + I + G + CA \]
LM equation: \[ \frac{M}{P} = L(i, Y) \]
FX equation: \[ i = i^* + \left( \frac{E^c}{E} - 1 \right) \]

2. Suppose that the above tariff was expected to be permanent. How would this affect $E^c$? Show how this would directly affect the ISLM-FX, using a solid line for the outcome of #1 above, and a dashed line for additional changes. How would that affect the current account, and how would that affect the ISLM indirectly?

![ISLM-FX Diagram]

$E^c \downarrow$, so $CA \downarrow$
3. Suppose instead that the exchange rate was fixed. How would the tariff affect the balance of payments, and how would the monetary authorities be able to keep E from changing? Show how this would directly affect the ISLM-FX, using a solid line for the outcome of #1 above, and a dashed line for additional changes.

4. Using an aggregate demand – aggregate supply diagram, show how the effects of the tariff may differ depending on whether the economy is in recession or not. In which case would the tariff have a bigger effect on the price level, and how would that affect the real effective exchange rate? How would that in turn affect the current account?

5. Using your answers to the above questions, in which cases (fixed vs. floating rates, recession vs. full-employment) would a tariff be more welfare-enhancing for the Home country? In which cases would it be welfare-enhancing overall for both the Home and Foreign country it trades with?