

- 1) Explain briefly (2 or 3 sentences) why a monetary contraction for a small open economy under *fixed* exchange rates will have no effect on real income.

- 2) If a small open economy with a *flexible* exchange rate is experiencing a recession, what will automatically happen over time to its trade balance, foreign exchange rate, and national output? Illustrate graphically.

- 3) The Mundell-Fleming model take the world interest rate r^* as an exogenous variable. Let's consider what happens when this variable changes.
 - a) What might cause the world interest rate to rise?
 - b) In the Mundell-Fleming model with a floating exchange rate, what happens to aggregate income, the exchange rate, and the trade balance when the world interest rate rises?
 - c) In the Mundell-Fleming model with a fixed exchange rate, what happens to aggregate income, the exchange rate, and the trade balance when the world interest rate rises?

- 4) Suppose the government in a small developing economy places restrictions on agricultural *exports* (say in order to increase the domestic food supply and lower food prices). Use the Mundell-Fleming model to analyze the short-run effects of this policy on the exchange rate and real GDP (illustrate using the graphs) if the country has a:
 - a) flexible exchange rate
 - b) fixed exchange rate

- 5) Finally, use the Mundell-Fleming model to illustrate the short-run effects of the Mexican crises (discussed in the text) in a small open economy with a fixed exchange rate. What happens to output, and why?