

Homework 9
Principles of Economics
Prof. Sarah West
30 points

1. **(6 points)** State whether the following statements are true, false or uncertain, and explain.
 - a. Inflation hurts borrowers and helps lenders, because borrowers must pay a higher rate of interest.
 - b. If prices change in a way that leaves the overall price level unchanged, then no one is made better or worse off.
 - c. Inflation does not reduce the purchasing power of most workers.

2. **(4 points)** Increasingly, some of Chinese saving has been used to finance American investment. That is, the Chinese have been buying American capital assets.
 - a. If the Chinese decided they no longer wanted to buy U.S. assets, what would happen in the U.S. market for loanable funds? In particular, what would happen to U.S. interest rates, U.S. saving, and U.S. investment?
 - b. What would happen in the market for foreign currency exchange? In particular, what would happen to the value of the dollar and the U.S. trade balance?

3. **(4 points)** A can of soda costs \$1.00 in the United States and 12 pesos in Mexico.
 - a. What would the peso-dollar exchange rate be if purchasing-power parity holds?
 - b. What is today's actual peso-dollar exchange rate? Cite your source and provide the date. How does this compare to your answer in part (a)? Explain.

4. **(6 points)** *Saving and Investment in an Open Economy*
 - a. Derive the identity that relates saving to investment and net capital outflow. This is an open economy.
 - b. Now, use a graph of the market for loanable funds to show the effect of the lending crisis on saving and investment. Explain.
 - c. How would you expect what happened in the market for loanable funds to affect the trade deficit? Use graphs to explain your answer.

5. **(4 points)** For each of the following events, use graphs of aggregate demand and aggregate supply to explain the short-run and long-run effects on output and the price level:
 - a. The stock market rises sharply, increasing consumer wealth.
 - b. A tsunami substantially damages a country's ability to generate electricity.
 - c. A boom overseas causes foreigners to buy more U.S. goods.
 - d. The federal government cuts spending.

6. (6 points) *The Current Macroeconomy*

- a. Use information on GDP growth, CPI, one other macroeconomic indicator, and a graph of aggregate supply and aggregate demand to explain what is occurring in the U.S. economy. Please place these numbers in the table below:

	2010-I	2010-II	2010-III	2010-IV
% change in real GDP				
CPI				
Another indicator: _____				

- b. What is the Federal Reserve Bank doing in response to what you described in part (a)? Use a graph of the money market and explain in words.