Use the economic model we have studied in class to answer the following five questions. Label each question: True, False, or neither, and explain the reasons for your answers. Use fully-labeled graphs and equations in your explanations, but be sure to include words as well. Explain why any curve shifts. Credit for each question depends entirely on the quality of your explanations. Graphs and other material required for full credit are given in parentheses at the end of each question. Always begin in a long-run equilibrium with full employment output and current account balance.

1. Write the three equations of the DD, AA, XX model. (8 points)

2. A temporary reduction in investment will have no effect on the current account, but will cause a recession and will depreciate the domestic currency. (AA-DD-XX, short-run only). (23 points)
3. If the European Union imposes a permanent tariff on US goods, then our current account will go into deficit in the short run and return to balance in the long run. There will be no effect on output in either the short or long run, and the domestic currency will appreciate. (q graph for real exchange rate, mathematical expression for relative price of foreign to US goods inclusive of tariff, short-run and long-run AA-DD-XX graph, explanation for magnitudes of shifts in curves) (23 points)
4. A permanent contraction in the US money supply will cause the short-run exchange rate to appreciate by more than the long-run exchange rate because a reduction in the money supply generally increases the nominal interest rate. There will be a recession in the short-run and a current account deficit, but both return to balance in the long-run (short-run and long-run AA-DD-XX graph, reasons for shift in each curve, definition of monetary neutrality and interest rate parity) (23 points)
5. The US could depreciate its currency and create a current account surplus in the short run either by reducing government spending permanently or by increasing the money supply permanently. (One q graph, two AA-DD-XX curves with short runs only in each) (23 points)