Use the economic model we have studied in class to answer four of the following five questions. Label each question: True, False, or neither, and explain the reasons for your answers. Use graphs and equations in your explanations, but be sure to include words as well. Credit for each question depends entirely on the quality of your explanations. Graphs 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. A tariff on imported goods will switch demand to domestic goods, raising output and creating a current account surplus in a short-run equilibrium. (short-run only, AA-DD-XX graph for simple model with \( Y_f \) exogenous)

2. A fall in wealth (due perhaps to a collapse in home prices) will appreciate the domestic currency, creating a current account deficit and a recession in the short run. [Hint: view the fall in domestic wealth as also reducing world relative demand for domestic goods.] (short-run AA-DD-XX graph)

3. Interest rate parity and sticky prices imply that a permanent increase in the money supply will create a permanent current account surplus and exchange rate overshooting. [Hint: be sure to use and define interest rate parity, sticky prices, and exchange rate overshooting in your answer.] (short-run and long-run AA-DD-XX graph)

4. Assume that a country begins with a zero government budget deficit and a zero current account deficit. From this initial position, an increase in government spending must create twin deficits in the short run. [Hint: consider alternative methods of financing the increase in spending and define “twin deficits”.] (short-run AA-DD-XX graph(s))

5. Purchasing power parity and monetary neutrality imply that any shock or policy change which causes the dollar to depreciate in the short run will cause prices to increase in the long run. [Hint: be sure to use and define purchasing power parity and monetary neutrality in your answer.] (short and long-run AA-DD-XX graph(s) for simple model with \( Y_f \) exogenous).