Use the economic model we have studied in class to answer five of the following six 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.

1. A permanent open market purchase of domestic government bonds by the central bank can be used to stimulate an economy out of recession under flexible exchange rates but not under fixed rates. (short-run only, 2 AA-DD graphs)
2. Permanent monetary contraction under flexible exchange rates creates a current account surplus in the long run and in the short run (short-run and long-run AA-DD-XX graph)
3. The U.S. current account deficit could be eliminated permanently by a sufficiently contractionary fiscal policy. (short-run and long-run AA-DD-XX graph)
4. Under flexible exchange rates, a permanent expansion of foreign output increases exports, increases the current account surplus, depreciates the domestic currency, and increases the level of output in the long and short runs. The shock has no effect on the real exchange rate. (short-run and long-run AA-DD-XX graph)
5. Under flexible exchange rates, an increase in the expected future exchange rate creates exchange rate depreciation. Under fixed rates, it requires an increase in the money supply to keep the exchange rate fixed. (2 money market equilibrium and IRP graphs)
6. Assume that in the midst of an international financial crisis, investors rush to safety, and this breaks interest rate parity by reducing the interest premium on the US dollar. If the central bank does not respond by changing the money supply and exchange rates are flexible, this reduction in the interest premium appreciates the dollar, reduces the current account, and creates a recession. (money market equilibrium and IRP graph, AA-DD-XX graph)