Mundell-Fleming Problem Set

1. Assume that there is a floating exchange rate. Suppose that consumers become more confident and for any given level of income, they want to consume more and save less. What happens to income, the interest rate, the exchange rate, consumption, investment and net exports? Explain using a diagram.

2. Assume that there is a floating exchange rate. Explain how a government can increase net exports without changing output.

3. Suppose that a country has strict and effective capital controls so that the balance of payments equation $r = r^*$ is replaced with the current account balance equation $X(Y,e) = 0$. Using a diagram, explain what happens to the interest rate, the exchange rate (if it floats), consumption, investment and foreign exchange reserves (if the exchange rate is fixed) in the following scenarios:
    a. The exchange rate floats and there is an expansionary monetary policy.
    b. The exchange rate is fixed and there is an expansionary fiscal policy.