

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point on the assignment.

Note that when I ask for the Keynesian diagram of supply and demand for money, I am asking for a combined demand for money that includes the assets demand, transactions demand, and precautionary demand. The assets demand is the book's liquidity preference while the transactions demand is basically the demand for loanable funds (although it is hard to see that) and the precautionary demand is really both.

- 1) (15 points) Why is the supply of loanable funds the same thing as the demand for bonds?
- 2) (15 points) The Keynesian liquidity trap is the nearly horizontal part of the liquidity preference curve. Explain what causes the curve to take that shape.
- 3) (30 points) Illustrate on the Keynesian diagram of supply and demand for money, an increase in government spending. Explain why the line(s) moved as drawn.
- 4) (5 points) If the figure on page 169 represents the supply and demand for yen, ¥, with respect to the US\$, then is the price ¥/US\$ or US\$/¥? How do you know?
- 5) (35 points) Illustrate an increase in the interest rates in the USA on the supply and demand for ¥. Explain why the curve(s) moved as drawn. What will happen to the current account balance? Why?