1. (2 points) How would you expect a fall in a country’s population to alter its aggregate money demand function? How will that affect exchange rate?

2. (3 points) The velocity of money, $V$, is defined as the ratio of real GNP to real money holdings, $V = Y/(M/P)$ in the notation used in class. Use the money market clearing condition to derive an expression for velocity and explain how velocity varies with changes in $R$ and $Y$. (Hint: the effect of output changes on $V$ depends on the elasticity of aggregate money demand with respect to real output. Economists believe that this elasticity is less than unity.) What is the relationship between velocity and the exchange rate.

3. (2 points) In our discussion of exchange rate overshooting, we assumed that real output was given. Assume instead that an increase in the money supply raises real output in the short run. How does this effect the extent to which the exchange rate overshoots? Describe using a diagram.

4. (3 points) Suppose the Federal Reserve announced that the money supply would be doubled next month. Describe the effect of the announcement on today exchange rate. Depict an appropriate diagram. Does exchange rate overshoot? Show also the time path of exchange rate.