

### Project 3 The Financial Crisis : Answers

What Chapters / models do you see in this case?

Chapter 6 (the natural rate of unemployment)

Chapter 12 (flexible vs. fixed exchange rates)

Chapter 13 (Phillips Curve)

Are all the findings consistent with your expectations?

	Theory	Empirics
Fiscal Policy (flexible)	Increase in exchange rate No real GDP growth No change in the money supply	Increase in exchange rate Recovery Lower money supply (monetary policy deemed necessary)
Fiscal Policy (fixed)	Quick recovery Increase in the money supply	Recovery Increase in the money supply (then a decrease)
Unemployment US	Return to $U^*$	Negative output gap. Unemployment increasing
Unemployment CN	Return to $U^*$	Closed the gap
Phillips Curve US	Should show inverse relationship	Does not
Phillips Curve CN	Should show inverse relationship	It does

If not, what assumptions about the model may be being violated?

Inflation expectations, small vs. large open economy, the RMB as a fixed rate currency

What can you say about each of the two countries' efforts to close the output gap?

China was far more successful in managing the gap. As usual, the structural efficiency of a totalitarian state allows policy to more effectively become practice. While the US politicians fought over the minutiae in a funding bill, Chinese aid was already reaching the affected citizenry.