BE-MACRO (ASSIGNMENT -2)

ROLL NO.408

1. C
2. D
3. B
4. A
5. A
6. C
7. B
8. A
9. C
10. D
11. D
12. A
13. B
14. C
15. D
16. C
17. C
18. B
19. A
20. D
21. B
22. B
23. A
24. C
25. B
26. A
27. A
28. C
29. B
30. D
31. C
32. A
33. C
34. B

35. B
36. C
37. D
38. D

39. Advantages of inflation targeting:
    - It will lead to increased transparency and accountability.
    - Policy will be linked to medium/long term goals, but with some short term flexibility.
    - With inflation targeting in place, people will tend to have low inflation expectations. If there was no inflation target, people could have higher inflation expectations, encouraging workers to demand higher wages and firms to put up prices.
    - It also helps in avoiding boom and bust cycles.
    - If inflation creeps up, then it can cause various economic costs such as uncertainty leading to lower investment, loss of international competitiveness and reduced value of savings. This can also be avoided with targeting.
    - Inflation targets can have various benefits, especially during ‘normal’ economic circumstances. However, the prolonged recession since the credit crunch of 2008 has severely tested the usefulness of inflation targets

Disadvantages of inflation targeting:

- It puts too much weight on inflation relative to other goals. Central Banks Start to Ignore More Pressing Problems like unemployment.
- Inflation target reduces “flexibility”. It has the potential to constrain policy in some circumstances in which it would not be desirable to do so.
- Cost-push inflation may cause a temporary blip in inflation.
- It cannot help remove supply bottlenecks and shortages
- It cannot help external shocks, exchange rate might suffer in the short run
- Growth and employment might take hits in the short run

40. The demand for money depends on three main factors: national income, the price level and the rate of interest. Transactions demand and precautionary demand vary directly with the first two factors but speculative demand for money vary inversely with the market rate of interest.

41. An exchange rate index is a way of measuring the performance of a currency against a basket of other currencies. An exchange rate index shows the percentage change in the value of the currency against its main competitors. It sets the index to 100 for a particular base year.
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42. The fiscal deficit is keenly observed during the Budget as the size of the deficit may affect growth, price stability, cost of production, and inflation. At times, a sustained high fiscal deficit can impact a country's rating. An increase in the fiscal deficit, however, can also boost a sluggish economy.
43. .
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46. In microeconomic theory, people are assumed to be rational and seeking to maximize their utility function. In the labour market model, their utility function expresses trade-offs in preference between leisure time and income from time used for labour. However, they are constrained by the hours available to them.
If the wage rate rises above the equilibrium then some unemployment will arise. This would be known as real wage or classical unemployment. This is shown in Figure 1 below as disequilibrium unemployment. If the labour market is free to return to equilibrium, then the disequilibrium wage rate will not last for long. The excess supply of labour and wage rates will fall. But if wages are sticky (downwards) then this may not be possible. Even at full employment some unemployment will arise, as markets are always in a state of change.

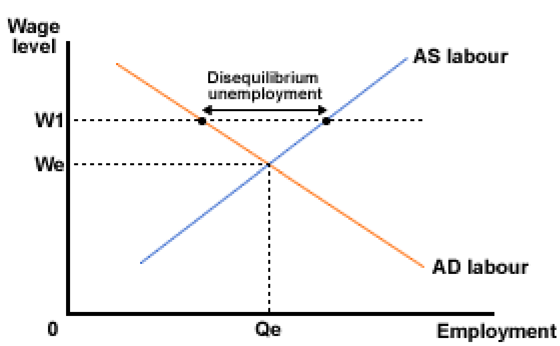

Figure 1 Disequilibrium unemployment

However, it is possible for there to be unemployment at the equilibrium wage as well. Even though the demand for labour may match the supply of labour in equilibrium, there may still be people who are unemployed. This may be because they are stuck in an unemployment trap where they are earning more on benefits than they could in work, or it may be because the industry they were working for has been shrinking and their skills are not required any more and are of no use in other areas. This type of unemployment is called equilibrium unemployment and is shown in Figure 2 below, and is essentially frictional and structured unemployment.

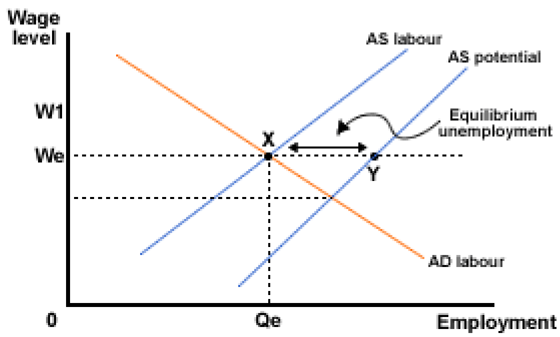

Figure 2 Equilibrium unemployment

In the diagram above, theX represents the aggregate supply of labour at the going wage and the Y represents the potential aggregate supply of labour. XY therefore represents the equilibrium unemployment, consisting of those who are frictionally and structurally unemployed.

47. In a floating system, the rules of supply and demand govern a foreign currency's price. Therefore, an increase in the amount of money will make the denomination cheaper for foreign investors. And an increase in demand will strengthen the currency (make it more expensive).
    A fixed or pegged rate is determined by the government through its central bank. The rate is set against another major world currency (such as the U.S. dollar, euro, or yen). To maintain its exchange rate, the government will buy and sell its own currency against the currency to which it is pegged.