1] C- A competitive economy free of Government intervention would result in full employment.

2] B- Real wages are back at long-run equilibrium level

3] B- There is excess supply, and the exchange rate should fall.

4] D- Interest rate must fall to restore equilibrium in the goods market.

5] D- Quantitative easing

6] B- Demand shocks are always very small

7] C- Negative relationship between inflation and unemployment

8] A- Strengthen

9] B- Government consumption expenditure

10] C- The price level must have risen by the same proportion as the increase in the money supply

11] D- Imposition of Indirect Tax

12] A- Negative

13] B- There is a “trade-off” between inflation and unemployment in the short run.

14] C- An inflow of foreign investment into country X.

15] D- A contractionary monetary policy.

16] A- Revenue Account

17] B- Frictional unemployment

18] B- Money works as a factor of production

19] C- Transaction and Precautionary

20] D- Certificate of deposit

21] B- Cash reserves + Credit money

22] D- Fiscal stimulus to the economy

23] A- Open Market Operations

24] C- Repurchase rate

25] A- The extent to which investors prefer to keep their assets in cash holdings

26] D- Accumulating money for saving does not create demand for money

27] F- Increases

28] K- 2016

29] M- non-accommodative

30] C- A reduction in trade union powers.

31] C- Rise while import value may rise or fall.

32] B- The purchase of shares in an Indian company by foreign investors.

33] A- Fluctuate more than consumer expenditure.

34] C- Increase and the domestic money supply rise.

35] D- Import volumes will increase

36] B- High rates of interest are discouraging borrowing.

37] D- Provision of infrastructure

38] A- Interventionist supply-side Policy

39] Inflation targeting allows central banks to respond to shocks to the domestic economy and focus on domestic considerations. Stable inflation reduces investor uncertainty, allows investors to predict changes in interest rates, and anchors inflation expectations. If the target is published, inflation targeting also allows for greater transparency in monetary policy.

However, some analysts believe that a focus on inflation targeting for price stability creates an atmosphere in which unsustainable speculative bubbles and other distortions in the economy, such as that which produced the 2008 financial crisis, can thrive unchecked (at least until the inflation trickles down from asset prices into retail consumer prices).

Other critics of inflation targeting believe that it encourages inadequate responses to terms-of-trade shocks or supply shocks. Critics argue that exchange rate targeting or nominal GDP targeting would create more economic stability.

40] **The demand for money** is affected by several factors, including the level of income, interest rates, and inflation as well as uncertainty about the future. The way in which these factors affect money demand is usually explained in terms of the three motives for demanding money: the **transactions**, the **precautionary**, and the **speculative** motives.

Transactions motive. The **transactions motive** for demanding money arises from the fact that most transactions involve an exchange of money. Because it is necessary to have money available for transactions, money will be demanded. The total number of transactions made in an economy tends to increase over time as income rises. Hence, as income or GDP rises, the **transactions demand** for money also rises.

Precautionary motive. People often demand money as a *precaution* against an uncertain future. Unexpected expenses, such as medical or car repair bills, often require *immediate payment.* The need to have money available in such situations is referred to as the **precautionary motive** for demanding money.

Speculative motive. Money, like other stores of value, is an asset. The demand for an asset depends on both its **rate of return** and its **opportunity cost.** Typically, money holdings provide *no* rate of return and often depreciate in value due to inflation. The opportunity cost of holding money is the interest rate that can be earned by lending or investing one's money holdings. The **speculative motive** for demanding money arises in situations where holding money is perceived to be *less risky* than the alternative of lending the money or investing it in some other asset.

41] i) 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.

ii) This is because a less developed country like India depends on developed countries like USA for the import of plant and machinery land related technology) for its development programmed. This causes a situation of adverse or negative balance of payments for the less developed countries. Accordingly, their forex reserves are low while the need for such reserves (to cope with rising imports) continues to be high. Paying more and more for a dollar in the international market) is Leads to high exchange rate.

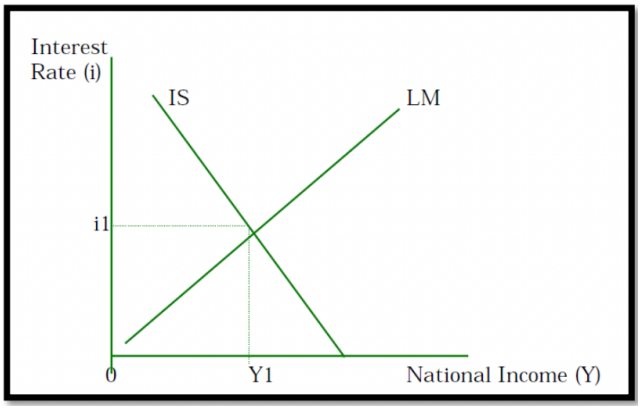
42] The direct effect of a rise in interest rates is to raise the cost of current government borrowing and so raise the fiscal deficit. In addition, it will raise the cost of financing the national debt to the extent that the debt has been financed by floating rate debt. The indirect effects of a rise in interest payments are also likely to widen the fiscal deficit initially since the interest rate rise will slow down the economy so increasing government expenditure on social security and dampening government tax revenues.

43] i) a. Money supply will be unaffected because the public's cash is withdrawn from banks and government spends it, so it is redeposited in the banking system. Hence, no overall change in the amount of cash held in the banking system.

b. Increase because there will be more cash deposited in banks, rather than being held outside of the banking system, which they can use to create credit.

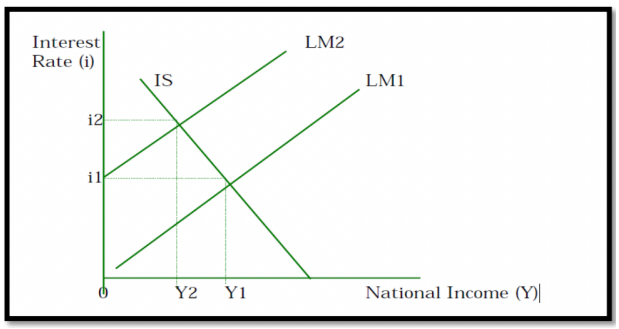
ii) a. A fall in the national income leads to a decrease in the transactions demand for money. The demand for money curve will shift to the left.
b. A decrease in the expected value of domestic currency will cause a decrease in the demand for the currency, i.e., the demand for money curve will shift to the left.

44] i) Points on the IS curve show combinations of interest rates and national income at which injections equal withdrawals and consequently the total output (national income) equals total expenditure, giving equilibrium in the markets for goods and services. Points on the LM curve show combinations of interest rates and national income at which the demand for money (liquidity) equals the supply of money, giving equilibrium in the money markets.

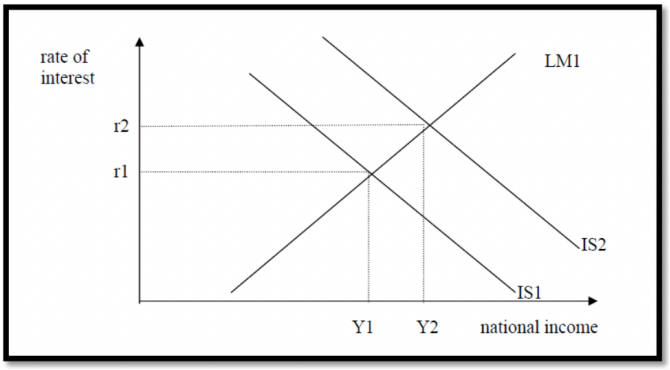


The IS-LM curves are drawn on a graph with interest rates on the vertical axis and national income on the horizontal axis. The IS curve slopes downward from left to right showing that lower rates of interest lead to higher levels of national income. The LM curve slopes upward from left to right showing that in order to obtain equilibrium in the money market, given the supply of money, higher levels of national income are associated with higher rates of interest. At the rate of interest and level of national income where the IS-LM curves intersect in the graph both the money market and the market for goods and services are in equilibrium.

ii) An increase in the average price level will result in a reduction in the real value of the money supply. A reduction in the money supply will shift the LM curve to the left giving an increase in the equilibrium rate of interest and a fall in the equilibrium level of national income. The reduction in the money supply gives an excess demand for money causing rates of interest to rise. The rise in interest rates discourages investment and consumer expenditure, reducing injections and causing the equilibrium level of national income to fall.



iii) With an expansionary fiscal policy financed by the sale of bonds, the government sells bonds and uses the proceeds raised to finance increased government expenditure. The effect on the money supply should be zero as the money raised from the bond sales is spent by the government. However, the increase in the supply of bonds for sale pushes down bond prices and raises the interest rate. There is a multiplier effect associated with the increase in government expenditure which is only partially offset by the effect of rising interest rates on consumption and investment so there is a net increase in the level of national income. This is depicted in the diagram below with the increase in government expenditure shifting the IS curve to the right from IS1 to IS2 and the interest rate rising from r1 to r2 and the level of national income rising from Y1 to Y2.



45] i) **Line 1** - Exports The balance of trade in goods is the net figure of exports and imports. We therefore have: Exports =425 -40 Exports are therefore equal to $385m

Line 6 - Balance of trade in services The balance of trade in services is the net of exports and imports of services. We therefore have: 165 - 185 = balance of trade in services The balance of trade in services is therefore -$20m.

Line 8 - Income payments The net income receipts (line 9) are the net of income receipts and income payments. We therefore have: 190 - income payments = 15 Income payments are therefore -$175m.

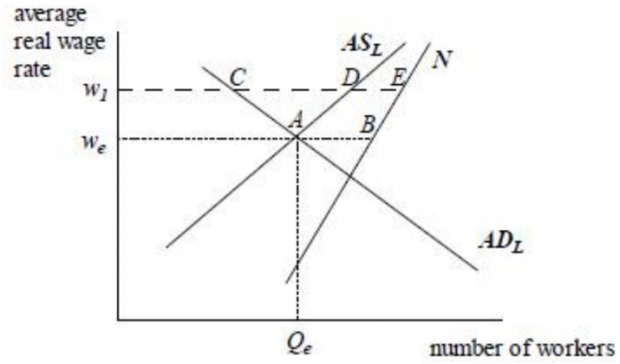
Line 11 - Net income flows Net income flows are the net of net income receipts and net current transfers. We therefore have:

15 - 50 = net income flows Net income flows are therefore -$35m.

Line 12 - Current account balance The current account balance is the sum of the balance of trade in goods (line 3), the balance of trade in services (line 6) and net income flows (line 11). We therefore have: -40 -20 - 35 = current account balance The current account balance is therefore -$95m.

Line 18 - Capital and financial account balance The balance of payments has to balance. In other words the net of the current account balance and the capital and financial account balance must be 0. Since the current account is -$95, the capital and financial account balance must be +$95m.

46]i)



The aggregate demand for labour curve (ADL) shows the total demand for labour at different average real wage rates. It assumes that at higher wages, employers take on fewer workers. The curve labelled N shows the registered labour force. It assumes that more people are willing to enter the labour force at higher wage rates.
The aggregate supply of labour curve (ASL) shows the number of people willing and able to accept jobs at each wage rate. It assumes that at higher wage rates more people become willing to accept jobs. The difference between the N and ASL schedules represents the number of people who are in the labour force, but who are not immediately willing or able to accept a job at the current wage rate.

ii) The labour market is in equilibrium with a real wage of we and an equilibrium level of employment Qe (i.e. when ADL= ASL). At the real wage we , there is unemployment of AB. This is called the equilibrium level of unemployment. If wages are held above the equilibrium at a wage of w1, then total unemployment is CE. Of this, DE consists of those workers who are not willing or able to accept a job at w1, but CD is a result of excess supply of labour and is called disequilibrium unemployment.

Reasons for equilibrium unemployment
1. Frictional unemployment
2. Structural unemployment
3. Technological unemployment
4. Regional unemployment
5. Seasonal unemployment

Reasons for disequilibrium unemployment
1. Demand deficient unemployment
2. Real-wage unemployment
3. Growth in labour supply

47] 1. Frequent changes in currency value could adversely affect trade and investment by creating uncertainty and losing business confidence. Government, therefore, wish to prevent fluctuations in currency value.

2. The measures available to the central bank in this regard would depend on whether the aim is to curtail day to day or longer term changes in exchange rate.

3. If the government aims to maintain the value of currency close to a long term equilibrium value , it could buy or sell the domestic currency in the foreign exchange market. The central bank's intervention will result in reverse shifts in demand and supply curves and the desired exchange rate would be restored.

4. To alleviate the downward pressure on the currency, the government could borrow foreign currency from other countries and international agency like IMF. It could use the loan to buy domestic currency in international market. This will result in returning the demand and supply curves to the original positions and the currency value to resume its original level.

5. The another measure is; the government could raise interest rate temporarily. This will encourage those aboard to deposit their money in the domestic country. Raising interest rate will result in an increase in demand for and decrease in supply for domestic currency.

6. Government can use fiscal and monetary policies to maintain the monetary value of the currency for longer periods such as months and years.

7. Contractionary fiscal and monetary policy can be used to reduce aggregate demand. A contractionary fiscal policy would involve raising taxes / reducing government spending. A contractionary monetary policy would involve raising interest rate to reduce borrowing and hence aggregate demand.

8. A reduction in aggregate demand would reduce expenditure on imported goods and hence reduce supply of currency in foreign exchange market. A reduction in aggregate demand would also reduce inflation. With lower prices in domestic market, exports will be cheaper and more attractive to consumers aboard and hence increase their demand for domestic currency. There will also less demand for expensive foreign goods leading to lower imports and lower supply of domestic currency. Both effects will support value of domestic currency.

9. The government may also improve supply side policies like improving the long term competitiveness of the domestic industry by improving quality of goods produced and lowering the production cost. This can be achieved for quality of training and research / development.

48] i) 30m surplus

ii) 10m deficit

iii) -40m

iv) No, the country does not have a fully flexible exchange rate. We can deduce this from the entry decrease in official reserves" which indicates that the central bank has been purchasing the domestic currency.