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Date 15/03/22 Subject BEM-Macro Topic: Assignment 2

Teacher's Remarks

BEM Assignment 2

1) C. A competitive economy free of government intervention would result in full employment.

2) A. Nominal wages are equal to expected wages.

3) C. There is excess demand and the exchange rate should rise.

4) D. Interest rate must fall to restore equilibrium in goods market.

5) D. Quantitative Easing.

6) D. Economies never displayed demand-deficient unemployment

7) C. Negative relationship between inflation and unemployment.

8) ~~A. Strengthen~~ B. Weaken

9) C. Information on job availablity

10) B. The velocity of circulation must have fallen.

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 foriegn investment in country X.

15) D. A contractionary monetary policy

16) D. Unilateral transfers

17) A. Full employment

18) C. money plays a neutral role in modern economy

19) C. Transaction and precautionary

20) A. Credit Money

21) C. cash reserves + credit money + other deposits

22) C. Debt Manager to the government

23) A. Open Market Operations

24) B. Tax cuts

25) A. The extent to which investors prefer to keep their assests in cash holdings.

26 ~~26~~) D. accumulating money for saving does not create demand for money.

27) f. Increases

28) K. 2016

29) o. Dovish

30) D. Better education and training

31) B. Fall while import values must rise

32) B. The purchase of shares in an Indian company by foriegn investors

~~33)~~

33) A. Fluctuate more than consumer expenditure

34) A. Decrease and the domestic money supply rise

35) C. Export values measured in the domestic currency will increase

36) ~~D~~ B. High rates of interest are discouraging borrowing

37) D. Provision of infrastructure

38) C. Merger Policy

39) A low rate of inflation means low demand for labour and so in short run, this would increase pool of unemployed individuals in the country and so we need to trade-off between inflation and unemployment in country & so we try to maintain inflation to a specific range. Also, as inflation is directly proportional to growth of the country, it is therefore empirical to ~~m~~ maintain a standard amount of inflation to encourage growth in the economy.

40) The demand for money refers to the desire to hold money rather than spending in goods & services. The reasons for the same are:

1] Transaction motive - Money is required for conducting transactions. People need to hold money because they recieve money only on intervals & not continuously

2] precautionary motive - Money can be held as a precaution for any unforseen events. For eg:- firms may keep balances for uncertainties about timing of their reciepts & payments.

3] Speculative motive - People who want to buy assets or securities may hold money to buy these at later dates if they feel that the prices will likely fall.

41) i) Exchange rate index is the weighted average exchange rate of a currency against all other currencies. We use this metric to deal with the problem of different changes in price of a ~~co~~ currency to every other currency.

ii) Less developed countries depend on developed countries for export of many new technologies & other related imports. This results in a situation of negative balance of payments for the less developed countries. Their foriegn exchange reserves fall as a result. i.e. demand for foriegn exchange exceeds its supply resulting in high exchange rate & so the equilibrium exchange rate is unfavourable for less developed countries.

~~3(b) i)(a) Non-bank private sectors gives out borrowings & so we can say that these sectors will have lower liquidity ratio. The banks will have greater proportion of cash deposits rather than in peoples wallets. This extra deposits allow banks to create more credit & therefore increases money supply.~~

~~(b)~~

~~42)~~

42) The direct effect of interest rate is to raise cost of current government borrowing & so raise fiscal deficit. It will raise cost of financing national debt to the extent that debt has been financed by floating rate debt. ~~Indirect~~ it may likely widen the fiscal deficit initially since interest rate rise will slow down the economy so increasing government expenditure on social security & dampening government tax revenues.

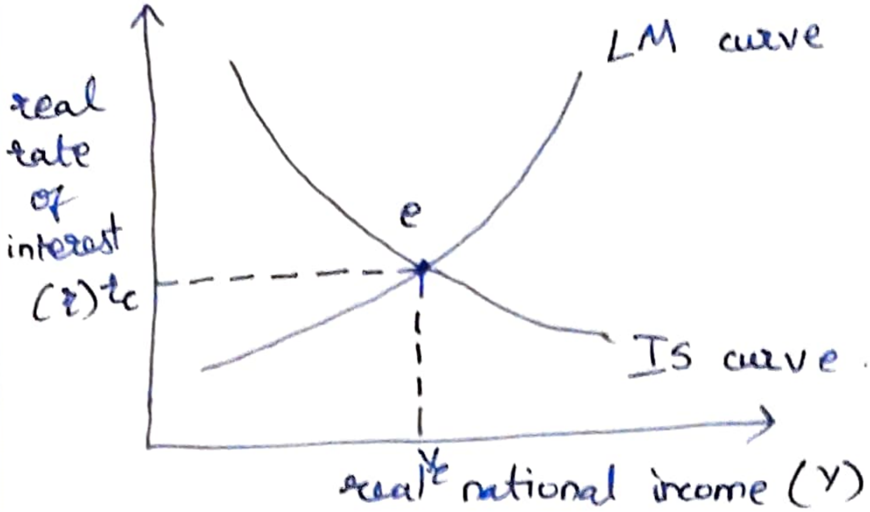
43) (i) (a) Public sector deficit is the difference between public-sector expenditure and public-sector reciepts. In general, the bigger the deficit, the greater will be the growth in the money supply. This is because a larger ~~fiscal~~ deficit encourages borrowing which will in turn create more credit.

(b) A decrease in non-bank sector holding in cash means greater proportion of cash base will be held as deposits in banks. This extra cash deposits allows banks to create more credit & therefore increases money supply.

(ii) (a) A fall in national income means people will now want to hold more money in hand rather than spending or investing it as a precautionary measure to cope up with decreasing incomes.

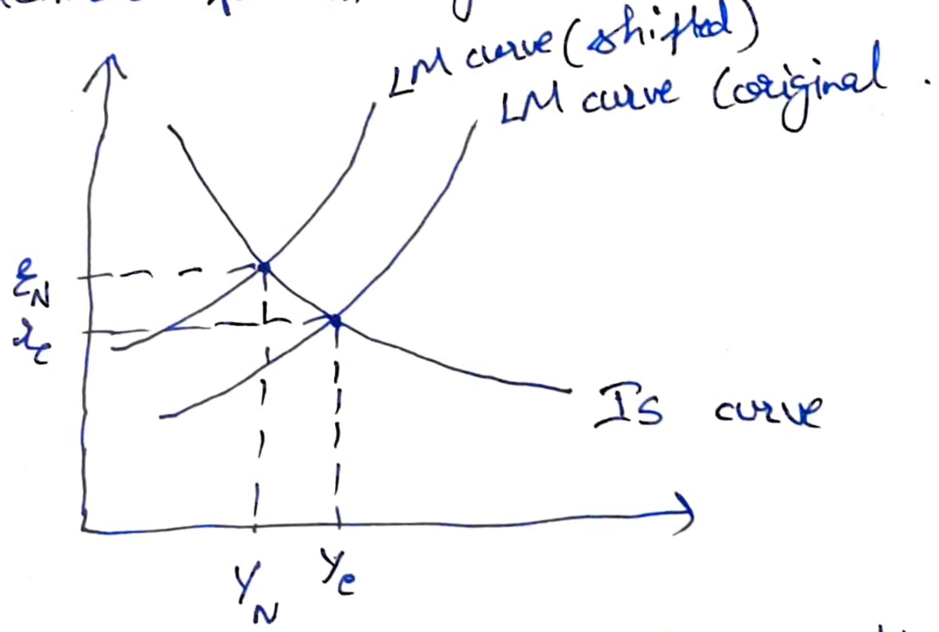
(b) If there is a fall in value of currency ~~national income~~, speculators might see an opportunity to buy ~~& hold~~ the currency at a cheaper rate & hold until the price increases, in turn increasing demand of the currency.

44) (i) The IS curve shows all possible equilibrium position in the goods market, it tells exactly what real rate of interest is required to achieve any desired level of output & employment. The LM curve shows all combinations of interest rates and levels of income such that the demand of money is equal to its supply.



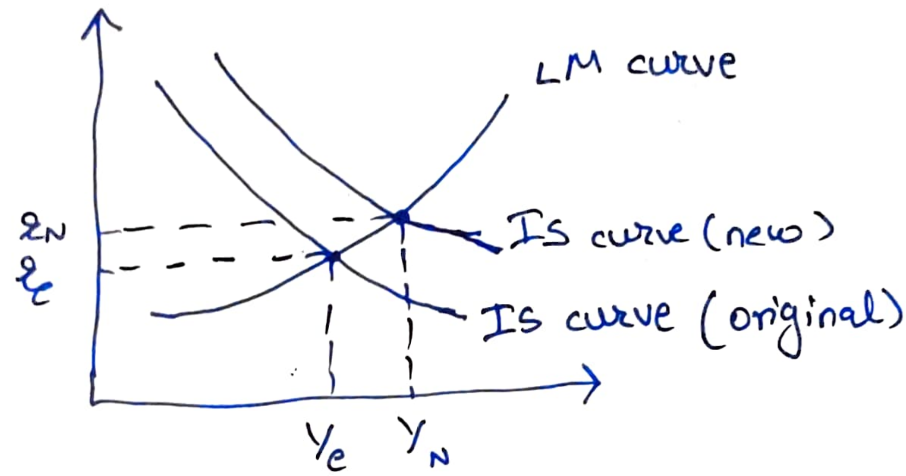
The IS curve shows all r & Y where goods market is in equilibrium & LM curve shows r & Y's where money market is in equilibrium. Both markets will be in equilibrium when both curves intersect. So r_e & Y_e are our equilibrium interest rates & national income respectively.

(ii) If price level rises, LM curve shifts left. This is because people need more money to pay the higher prices, but the higher resulting interest rates lower the demand for money.



the rate of interest increases but the national income decreases due to increase in average price level.

(iii) For an expansionary fiscal policy, the government increases its expenditure or reduces taxes. So this increases money supply. This shifts the IS curve to the right.



From the graph, we can see that expansionary fiscal policy increases both interest rates & national income.

45) i) exports of goods = −40 + 425 = +385

balance of trade in services = 165 − 185 = −20

Income payments (from investments) = −175

Net income flows = −35

Current account balance = −95

Capital & financial account balance = +95

(ii)(a) this will come under credit as money is recieved by the country & will come under income receipts in current accounts as this is an investment.

(b) this will come under capital account transactions (net) as this is credit card payment & so it will be payed back immediately.

(c) As this is a service done outside India, this will come under exports of services in current account.

46) (i) Labour market refers to the supply & demand of labour, wherein employees provide supply and employers provide demand.

(ii) equilibrium unemployment happens when the labor market is at equilibrium, means jobs exist but people are unable or unwilling to take the jobs that exist. This occurs when people leave their jobs & ~~tat~~ those who are temporarily u~~ne~~nemployed while looking for new job. There may be a change in economic structure due to change in demand pattern, a industry may decide to remove employees from work. Technological advancements may be ~~an~~ reason where technology replaces human labor, creating unemployment.

Disequilibrium unemployment is where due to imposition of minimum wage laws by government which means there will be higher demand for jobs then the supply. This may happen due to increase in labour supply without any increase in labour demand. This unemployment may also attribute to business cycle. For eg, at time of recession, unemployment will be high due to low labour demand.

47) frequent currency value changes would adversely affect trade & investments by creating uncertainty & losing business confidence. It could buy or sell the domestic currency in forex market. The central bank's intervention will result in reverse shifts in demand & supply curves & the desired exchange rate would be restored.

48) (i) 30 million surplus, (ii) 10 m deficit, (iii) -40 million

(iv) the country does not have fully flexible exchange rate. we can deduce this from entry decrease in official reserves which indicates central bank ~~#~~ has been purchasing currency.