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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE PROGRAMME

YEAR II SEMESTER II (INTAKE III/IV – GROUP A)
END SEMESTER EXAMINATION – JULY 2016

BEC 20225 Macroeconomics

Date	:	22nd July 2016
Time	:	9.00 a.m. – 11.30 a.m.
Duration	:	Two and a half (02 ½) hours

Instructions to Candidates:

- Paper consists of three sections (A, B, and C)
- Section A – Answer **ALL** questions in the separate sheet provided.
  Section B – Answer only **FOUR (04)** questions out of five.
  Section C – Answer only **ONE (01)** questions out of two.
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Answers should be written neatly and legibly.

Section – A

Answer **ALL** questions

Select the **most appropriate answer** for questions 1–10.

1. Gross domestic product (GDP) is;
   a. the market value of all final goods and services produced within a country in a given period of time.
   b. the market value of all intermediate goods and services produced within a country in a given period of time.
   c. the market value of all final goods and services produced by a nation in a given period of time.
   d. the market value of all final and intermediate goods and services produced within a country in a given period of time.

2. When the economy reaches the full employment level, any increase in government spending will cause;
   a. an increase in interest rate
   b. an increase in price level
   c. an increase in real output
   d. an increase in real money supply

3. The transactions demand and the speculative demand for money respectively depend on;
   a. the income and the interest rate
   b. the interest rate and the income
   c. the money supply and the interest rate
   d. the income and the money supply

4. If the government wants to increase the real output of the economy while holding the interest rate constant, preferred policy actions would be;
   a. an increase in government spending and decrease in money supply
   b. a decrease in both government taxes and money supply
   c. a decrease in government taxes and increase in money supply
   d. an increase in government spending while holding the money supply constant

5. Clinton – Greenspan policy mix is a real world example for;
    a. Expansionary fiscal and monetary policies
    b. Expansionary fiscal policy and contractionary monetary policy
    c. Contractionary fiscal policy and Expansionary monetary policy
    d. Contractionary fiscal and monetary policies

6. According to the IS-LM model, the long run equilibrium of the economy is achieved by;
    a. a reduction in the price level
    b. an increase in money supply
    c. an increase in the interest rate
    d. a reduction in government spending

7. Capability of one country to produce more of a product with the same amount of input than another country is known as;
    a. Acquired advantage
    b. Competitive advantage
    c. Absolute advantage
    d. Comparative advantage

8. European Union (EU) is an example for;
    a. a free trade area
    b. a customs union
    c. an economic union
    d. all the above

9. Foreign exchange market participants who trade in foreign currencies to benefit from the exchange rate fluctuations are called;
    a. Traders
    b. Arbitrageurs
    c. Hedgers
    d. Speculators

10. Purchasing power parity (PPP) explains that;
    a. high interest rate on a currency is offset by the forward discount and low interest rate by forward premium.
    b. exchange rate between the currencies of the two countries will adjust to reflect changes in the inflation rates.
    c. there is a relationship between spot exchange rate, forward exchange rate and relative interest rates.
    d. exchange rate will adjust to reflect changes in both inflation rates and interest rates in two or more countries.

(Total 20 Marks)

Section - B

Answer only **<u>four (04)</u>** questions.

<u>Question No. 01</u>

"When economists think about year-to-year movements in economic activity, they focus on the interaction between production, income and demand."

i. How the values obtained for above three (03) variables are equal in national accounting process? Justify your answer.

(05 Marks)

ii. What is the role of the financial sector in maintaining the interaction between production, income and demand? Explain.

(05 Marks)

iii. What is the role of the government in managing the macroeconomic stability? Explain.

(05 Marks)

(Total 15 Marks)

Question No. 02

i. Briefly explain the competitive factors and key characteristics of factor-driven stage and efficiency-driven stage of an economy.

(05 Marks)

ii. What do you mean by supply-side economic policies? What are the supply-side economic policies that a government applies in each stage of competitiveness of an economy?

(05 Marks)

iii. Explain the main political economic systems in the world with their key characteristics.

(05 Marks)

(Total 15 Marks)

Question No. 03

Consider the following data of the goods market of a small hypothetical economy. (Values are in millions.)

$C = 15 + 0.75Y_D$	(Consumption function)
$T_g = 4 + 0.2Y$	(Tax function)
$R = 10.66$	(Government transfers)
$G = 50$	(Government expenditure)
$I = 32$	(Investment expenditure)

i. Determine the values of the following:
   a. The multiplier
   b. Total autonomous spending
   c. Equilibrium national income

(06 Marks)

ii. a. Suppose that the government increases its expenditure by 10 million in order to raise aggregate demand. Calculate the increase in equilibrium national income.

(02 Marks)

   b. If the government decided to reach the same equilibrium national income in question (a) above by changing the government taxes, what should be the new marginal tax rate? *(assume, G = 50)*

(02 Marks)

iii. If the government will reduce its spending by an amount exactly equal to the current budget deficit, will it be able to have a balanced budget? Give reasons for your answer (you are not supposed to do any calculations here.)

(05 Marks)

(Total 15 Marks)

Question No. 04

The following data is assumed to represent the macroeconomic environment of a hypothetical economy. (Values are in millions.)

$C = 390 + 0.4Y_D$	(Consumption function)
$I = 100 - 12r$	(Investment function)
$G = 30$	(Government expenditure)
$T = 40$	(Government tax)
$\left(\frac{M}{P}\right)^S = 100$	(Real money supply)
$M_t = 0.4\text{Y}$	(Transactions demand for money)
$M_{sp} = 34 - 82\text{r}$	(Speculative demand for money)

i. Derive the equations for IS and LM curves.

(05 Marks)

ii. Find the equilibrium output (Y) and interest rate (r).

(03 Marks)

iii. Solve for the equilibrium values of ‘C’ and ‘I’ and verify the value you obtained for ‘Y’ by adding up the components of aggregate demand.

(02 Marks)

iv. Now suppose that the real money supply increases to 190. Solve for ‘Y’, ‘r’, ‘C’ and ‘I’. Describe the effects of this expansionary monetary policy on the economy.

(05 Marks)

(Total 15 Marks)

Question No. 05

i. International trade theory explains the pattern of international trade observed in the world economy.

   a. What is the difference between the theory of absolute advantage and the theory of comparative advantage? Explain using examples.

   (04 Marks)

   b. How does the Heckscher-Olin theory describe the pattern of international trade between nations? Explain.

   (03 Marks)

ii. Graphically explain the trade creation and trade diversion effects with regard to a customs union.

   (04 Marks)

iii. What is 'triangle arbitrage' in foreign exchange market? Explain with an example.

   (04 Marks)

(Total 15 Marks)

Section - C

Answer only **one (01)** question.

Question No. 01

"The IS–LM model is designed to explain the economy in the short run when the price level is fixed."

i. Graphically explain the derivation of aggregate demand curve of an economy using the IS-LM model.

   (08 Marks)

ii. How does the model describe the shift of an economy from short run to the long run equilibrium? Explain using graphs.

   (12 Marks)

(Total 20 Marks)

Question No. 02

"The Solow growth model primarily stresses the importance of capital accumulation through savings and investment in the process of economic growth and development."

i. What is meant by 'steady state level of capital' and 'golden rule level of capital' as described in the model? Explain using graphs.

(10 Marks)

ii. Evaluate the significance of the above two (02) concepts in economic growth and development.

(10 Marks)

(Total 20 Marks)