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

YEAR II SEMESTER II – INTAKE V/VI (GROUP A) END SEMESTER EXAMINATION – JULY 2017

BEC 20225 Macroeconomics

Date	:	28th July 2017
Time	:	1.00 p.m 3.30 p.m.
Duration	:	Two and a half (02 ¹ / ₂) Hours

Instructions to Candidates:

- This paper consists of three sections (A, B and C).
- Section A Answer **ALL** the questions on the separate sheet given

Section B – Answer any Four (04) questions only.

Section C – Answer only One (01) the question.

- 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

Question No. 01

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

- 1. Economic growth of an economy is measured by the percentage change in;
 - a. nominal gross domestic product from one period to another.
 - b. real gross domestic product from one period to another.
 - c. production of goods and services from one period to another valued at current prices.
 - d. production of goods and services from one period to another valued at market prices.
- 2. According to Keynes which of the following is necessary to reinforce the changes in autonomous spending and restore the economy at full employment?
 - a. Government spending
 - b. Household saving
 - c. Investment
 - d. Exports
- 3. The demand for money in an economy depends on;
 - a. the interest rate
 - b. the income
 - c. the income and the interest rate
 - d. the supply of money
- 4. Expansionary monetary policy may cause which of the following in an economy?
 - a. A deflation
 - b. An appreciation of local currency
 - c. A depreciation of a local currency
 - d. An increase in interest rate

- 5. Clinton Greenspan policy mix is a real world example for;
 - a. Expansionary fiscal and monetary policies
 - b. Contractionary fiscal and monetary policies
 - c. Expansionary fiscal policy and contractionary monetary policy
 - d. Contractionary fiscal policy and expansionary monetary policy
- Expansionary fiscal policy initially causes the output to grow and the interest rate to rise.
 Later, this would reduce the output due to a reduction in investment. This is known as the;
 - a. Fiscal expansionary effect
 - b. Crowding out effect
 - c. Interest rate parity
 - d. Money market equilibrium
- 7. The Phillips curve explains the relationship between;
 - a. interest rate and national income.
 - b. inflation and national income.
 - c. interest rate and unemployment.
 - d. inflation and unemployment.
- 8. Economic integration which eliminates barriers among members only in exchanging goods and services while maintaining a common external trade policy is known as;
 - a. a free trade area
 - b. a customs union
 - c. a common market
 - d. None of the above
- 9. Which of the following is a non-tariff trade barrier that contracts external trade?
 - a. Voluntary export restraint
 - b. Voluntary import expansion
 - c. Import subsidies
 - d. Export subsidies

10. Hedging the exchange rate risk through a forward contract by an investor is known as;

- a. Covered interest arbitrage
- b. Uncovered interest arbitrage
- c. Triangular arbitrage
- d. Forward hedging

(Total 20 marks)

Section B

Answer only **four (04)** questions.

Question No. 02

i. Identify the key macroeconomic variables which should be controlled in order to stabilize the macro economy.

(03 marks)

ii. Why is the financial sector treated as the 'brain of an economy'? Explain.

(04 marks)

iii. a. Briefly explain the concept of 'political economy' in the present context with examples.

(04 marks)

b. Identify the nature of the recent transition of the political economy of developing nations.

(04 marks)

(Total 15 marks)

i. Briefly explain the main attributes of the efficiency-driven stage of an economy. What are the factors that determine the economic competitiveness in this stage?

(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. What do you mean by the 'steady-state condition' of the labour market? Explain.

(05 marks)

(Total 15 marks)

Question No. 04

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

$C = 150 + 0.75Y_D$	(Consumption function)
$T_g = 60 + 0.2Y$	(Tax function)
R = 20	(Government transfers)
G = 60	(Government expenditure)
I = 40	(Investment expenditure)

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

(08 Marks)

ii. 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)

iii. Why is the balanced budget multiplier equal to one (01)? Explain the reason.

(05 Marks)

(Total 15 marks)

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

$C = 450 + 0.6Y_D$	(Consumption function)
I = 180 - 10r	(Investment function)
G = 50	(Government expenditure)
T = 40	(Government tax)
$\left(\frac{M}{P}\right)^s = 135$	(Real money supply)
$M_t = 0.5$ Y	(Transactions demand for money)
$M_{sp} = 40 - 60r$	(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 nominal money supply and price level increases to 840 and 3, respectively. Solve for 'Y', 'r', 'C' and 'I'. Describe the effects of this monetary policy on the economy.

(05 marks)

(Total 15 marks)

i. What is the difference between absolute and comparative advantage of international trade? Explain with real world examples for each.

(05 marks)

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

(05 marks)

iii. What do you mean by 'protectionism'? Explain with socio-economic and political rationale of protectionism.

(05 marks)

(Total 15 marks)

Section C Answer only <u>one (01)</u> question.

Question No. 07

i. "When economists think about year-to-year movements in economic activity, they focus on the interaction between production, income and demand."
Elaborate the above statement with respect to a national economy.

(10 marks)

ii. Is gross domestic product (GDP) a good indicator of economic prosperity? Justify your answer with valid economic reasoning.

(10 marks)

(Total 20 marks)

i. Identify the roles of the government and the external sector in managing the macroeconomic stability.

(10 marks)

ii. Using a real world example, evaluate the application of fiscal and monetary policy mix in achieving macroeconomic objectives of an economy.

(10 marks) (Total 20 marks)