This question paper contains 4 printed pages]

Roll No. | | | | | | | | | | | |

S. No. of Question Paper : **7561**

Unique Paper Code . **2271301** **F-7**

Name of the Paper : **Macroeconomics—I**

Name of the Course : **B.A. (Hons.) Economics**

Semester : **III**

Duration : **3 Hours** Maximum Marks : **75**

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt any *two* parts from each question.

Each part carries **7.5** marks.

All questions are compulsory.

1. (*a*) (*i*) Explain the concept of full employment budget surplus. 2.5

(*ii*) If consumption is negatively related to interest rate, how would the IS curve be affected. 2.5

(*iii*) If the demand for money is not responsive to the rate of interest in an economy, how will this influence the LM curve. 2.5

(*b*) (*i*) What are 'automatic stabilizers' ? Explain. 2.5

(*ii*) Suppose money supply is positively related to interest rate. How would this affect the LM curve ? 2.5

(*iii*) What is the 'liquidity trap' ? Explain. 2.5

(c) (i) If the interest sensitivity of investment demand is equal to zero. how is the AD curve impacted ? 3

(ii) The AD curve is flatter (a) the larger the multiplier and (b) the smaller the income responsiveness of the demand for money. Explain. 4.5

2. (a) Distinguish between demand side and supply side crowding out. Mention at least *two* factors which determine the extent of crowding out. 5,2.5

(b) Explain how an increase in the price of oil leads to stagflation in the economy. How do real wages get impacted during the process of adjustment ? 5, 2.5

(c) Suppose the government announces an anti-monopoly legislation. What impact would it have on national output and price level both in short-run and medium-run ? 7.5

3. (a) (i) Assumption of rational expectations renders monetary policy ineffective with respect to national output even in short run. Explain with the help of Lucas supply curve.

(ii) Explain why errors of rational expectations are on average zero. 5, 2.5

(b) (i) According to Friedman, the trade-off between inflation and unemployment exists only in short run. Explain.

(ii) Discuss any *two* sources of business cycles suggested by Lucas. 3.5, 4

(c) (i) What do you understand by sacrifice ratio in the traditional Phillips curve approach ?

(ii) Show that Adaptive Expectations Hypothesis allows us to relate unobservable expected variables to observable actual variables. 3.5, 4

4. (a) Assume that capital is perfectly mobile, the price level and the exchange rate is fixed. Answer the following :

(i) What is the impact on the level of economic activity when there is an increase in money supply ?

(ii) Show that an increase in government expenditure is effective in raising the level of output in the economic. 4,3.5

(b) (i) What is the 'automatic adjustment mechanism'? How does it tackle the twin deficits in an economy ?

(ii) Assuming fixed exchange rates and flexible prices, explain the effect of devaluation on an economy. 4,3.5

(c) Distinguish between exchange rate systems—Adjustable Pegs, Crawling Pegs and Managed Floating. 7.5

5. (a) (i) Assume perfect capital mobility, flexible exchange rate and fixed prices. Let there be an exogenous increase in the rate of interest abroad. How would this impact the output, and the exchange rate of the domestic economy ?

(ii) "An expected change in exchange rate leads to an immediate actual change in exchange rate by an equal percentage." Explain. 4,3.5

(*b*) (*i*) What is the exchange rate 'overshooting model' ? Explain the phenomenon in the case where there is a one time increase in money stock in the economy. 5

(*ii*) What are the 'hysteresis effects' of overvaluation ? Explain. 2.5

(*c*) (*i*) Distinguish between the absolute purchasing power parity and relative purchasing power parity theory of the determination of exchange rates. 5

(*ii*) Establish that if the absolute PPP held, the relative PPP would also hold. 2.5