Minor 2

Course: MSL 720 "Marcoeconomic Environment of Business"
Time: 60 Minutes
Maximum Marks: 20

Instructions:

Question paper consists of two parts. Part I consists of multiple choice questions where each question carries 1 mark. All the questions are compulsory in part I. In Part II you have to answer any TWO of the three subjective questions. Each question carries 5 marks. **Draw neatly labeled graphs where necessary** otherwise your marks will be lower.

PART I

1. If investment becomes more responsive to changes in the interest rate, then
a. The size of the government spending multiplier will increase
b. A given increase in the interest rate will lead to a larger increase in income
c. The IS-curve will become flatter
d. The IS-curve will become steeper

2. If due to financial innovation, money demand decreases at each interest rate, the following will happen:
a. Money demand will shift to the left
b. Money demand will shift to the right
c. LM curve will shift down
d. Both (a) and (c)

3. If we were in a liquidity trap,
a. Investment would be totally interest insensitive
b. Fiscal expansion would be unlikely to drive interest rates up
c. Monetary policy would be more powerful than fiscal policy
d. An increase in government spending would be totally offset by a decrease in private investment

4. Assume the government wants to keep national income stable but change the composition of GDP away from consumption towards investment. What policy option would you suggest?
a. A decrease in transfer payments to households combined with open market purchases by the central bank
b. Expansionary fiscal policy combined with restrictive monetary policy
c. Open market sales by the central bank
d. A reduction in investment tax credits

5 Assume we combine restrictive monetary policy with expansionary fiscal policy. Which is most likely to occur?
a. Unemployment and interest rates will both go down
b. Unemployment will go down but interest rates will stay the same
c. Investment and consumption will both increase
d. Investment will decrease and the budget deficit will increase

6. If there is an increase in the income tax rate, then the IS-curve will
a. Become flatter and shift to the right
b. Become steeper and shift to the left
c. Become steeper and shift to the right
d. Shift parallel to the left

7. We can expect the IS-curve to get steeper, as
a. Money demand becomes less sensitive to changes in the interest rate
b. The marginal propensity to save increases
c. Investment becomes more sensitive to changes in the interest rate
d. The income tax rate decreases

8. The call money rate
a. Is not affected by open market operations
b. Is also known as the primary credit rate
c. Is the rate that banks have to pay if they borrow from the Central Bank
d. Is the rate a bank has to pay if it borrows from another bank

9. In an IS-LM model, any point that is to the left and below the IS-curve indicates a situation where
a. There is excess demand for goods and services in the expenditure sector
b. There is excess supply of goods and services in the expenditure sector
c. The expenditure sector is in equilibrium but the money sector is not
d. There is excess demand for money in the money sector

10. The monetary policy multiplier is large if
a. The LM-curve is steep and the IS-curve is flat
b. The LM-curve is flat and the IS-curve is steep
c. Money demand is very interest sensitive
d. Investment is very interest insensitive

PART II

Question 1.

Comment on the following statement: "An increase in money supply by the central bank does not affect the government budget surplus since this is a monetary policy change and not a fiscal policy change."

5 Marks

Question 2.

After the withdrawal of legal tender status on 500 and 1000 rupees notes; currency in circulation fell suddenly. Explain the impact of demonetization on interest rate and output with the help of IS-LM model.

5 Marks

Question 3.

In the year 2008, U.S. economy went into recession. There was a sharp decline in the rate of interest. Use the IS-LM model to explain this pattern of declining output and interest rates. Which curve must have shifted and why?

5 Marks