University of Ruhuna

2017/2018 Academic Year Master of Arts in Economics

1st Semester End Examination - Dec. 2018

MAE 5101 - Macroeconomic Theory

Answer **four (04)** questions selecting two (02) from sub – section A and B.

Time: 3 Hours

Sub – section A

01\. i. Distinguish between the stock and flow variables.

(03 Marks)

ii. Explain the following possible macroeconomic conflicting objectives in economic management.

a) Unemployment and price stability

b) Economic growth and the balance of payments.

c) Economic growth and inflation

d) Economic growth and environmental sustainability.

(08 Marks)

iii. Graphically explain the main phases of the business cycle.

(04 Marks)

02\. i. What are the basic functions of money?

(02 Marks)

ii. Distinguish between conventional and Chicago approaches to the definition of money.

(02 Marks)

iii. The following table provides selected monetary statistics of hypothetical economy for 2018.

	Item	2018 (Rs bn)
1.	Currency outstanding	220
2.	Currency with commercial banks	40
3.	Demand deposits held by the public with commercial banks	160
4.	Commercial bank's deposit with the central bank	90
5.	Broad money supply (M_2)	1550
6.	Foreign currency depostis that are included in M_{2b}	270
7.	Government agencies' deposits with the central bank	20

a) Calculate currency held by the public, Reserve money and savings and time deposits held by the public with commercial bank.

(03 arks)

b) Estimate the consolidated Broad money supply (M_{2b}) and the money multiplier for M_{2b}

(02 arks)

c) Explain the value of money multiplier for M_{2b} and list out the possible determinants of money multiplier.

(04 Marks)

d) What additional items are required to estimate the broad money supply (M_4) as measured by the financial survey?

(02 Marks)

03. i. Define the short – run phillips curve

(03 Marks)

ii. Discuss the reasoning behind the negative slope of the phillips curve.

(04 Marks)

iii. Describe elaborately reasons behind the collapse of the global stable phillips curve after 1970's with help of the real world evidence.

(04 Marks)

iv. "An unexpected increases in the money supply cause clockwise movements in the phillips curve diagram."
Evaluate above statement depending on the adaptive expectations theory to the phillips curve.

(04 Marks)

03. Explain the following concepts with the help of appropriate diagrams.

i. Speculative demand for money
ii. Expansionary monetary policy
iii. Cost – push inflation
iv. The political business cycle
v. Stagflation

(15 Marks)

Sub – Section B

05\. i. Describe the "Say's Law" and discuss the practical validity of this concept.

(04 Marks)

ii. Explain using the appropriate diagram, the mode of performance of an increasing the aggregate demand policy which suggested in the simple Keynesian Model for increasing the employment and output in a country.

(07 Marks)

iii. Explain the strengths and limitations of an implementation the simple Keynesian theory of income and employment determination to solve the unemployment problem currently experiencing by Sri Lanka.

(04 Marks)

06\. Suppose that the following equations are describing a hypothetical economy (value of all the autonomous variables are in Rupees Million)

Private consumption expenditure	$C = 120 + 0.8Y^D$
Private Investment Expenditure	$I = 100 - 10r$
Government Expenditure	$G = 50$
Government Tax revenue	$T = 50 + 0.05Y$
Net Export	$Xn = 10 - 0.01Y$
Demand for Money	$(M/P)^D = Y - 20r$
Supply of Money	$M^s = 660$

i. Calculate the IS and LM equations for this economy when price level is equal to one (P = 1)

(04 Marks)

ii. Calculate macro equilibrium income at P = 1

(02 Marks)

iii. Suppose the government of this economy has planned to increase the current equilibrium income by Rs. 50 million in the next year adjusting only the equilibrium of goods and services market.

a. Indicate three alternative policies open to this government to achieve its income target.

(03 Marks)

b. Select one out of policies from your list and explain the mode of dynamic of it on the economy.

(02 Marks)

iv. Calculate new levels of national income in the situations of increasing the current price level by 10% and 20%

(02 Marks)

v. Illustrate the Aggregate demand curve developed by the Modern Economists in a graph using national income calculations you obtained as answers to questions 6 – ii and 6 – iv.

(02 Marks)

07. i. Illustrate graphically the derivation of IS* and LM* curves were developed in the Mundell – Fleming model.

(04 Marks)

ii. Examine the specific characteristics those separate the Mundell – Fleming model from that of the traditional IS-LM model.

(05 Marks)

iii. Compare the long – term economic impact of an expansionary fiscal policy on the level of national income in a small open economy like Sri Lanka in the two situations of fixed exchange rate and floating exchange rate system.

(06 Marks)

08. Discuss critically the following statements using appropriate diagrams.

i. "The magnitude of the crowding out effect of increasing the government expenditure is depending on the slopes of IS and LM curves."

(08 Marks)

ii. "A depreciation of domestic currency relative to the trading partner's currency will result the net export schedule to shift outward.

(07 Marks)

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