

**The LNM Institute of Information Technology**  
**Department of HSS**  
**Macro Economics for Managers (HSS3101)**  
**End Term Exam**

**Time:** 180 minutes

**Date:** 10/12/2019

**Max. Marks:** 50

**Instructions:** Give examples and draw a diagram wherever applicable to support your answers. NO partial credits. Use of calculators is permitted. Attempt the paper in sequence and answer new section/question on a new page. [Total questions = 15]

**PART-I [14 Marks]**

**Q.1** What is the major difference between BSE and NSE. [1]

Answer = BSE's index is known by the name SENSEX (Sensitive Index) which shows 30 top trading companies. Nifty (National Fifty) is the index of NSE, displays 50 most traded companies.

**Q.2** Which contributes more to GDP – the production of an economy car or the production of a luxury car. Why? [1]

Answer = The production of a luxury car contributes more to GDP than the production of an economy car because the luxury car has a higher market value.

**Q.3** If inflation is less than expected, who benefits - debtors or creditors? Why? [1]

Answer = If inflation is less than expected, creditors benefit and debtors lose. Creditors receive payments from debtors that have a higher real value than was expected.

**Q.4** If, for a \$1000 premium, you buy a \$100,000 call option on bond futures with a strike price of 114, and at the expiration date the price is 110. What is the profit/loss? [1]

Answer = Your loss is \$1000.

**Q.5** Suppose Country A and Country B can both produce bicycles and computers. Assume also that Country A's opportunity cost of a computer is three bicycles, and Country B's opportunity cost of a computer is five bicycles. Answer to the following questions: [1+1]

**(a)** Which country has a comparative advantage in producing computers?

Answer = We know that the opportunity cost of a computer is 3 bicycles in A and 5 bicycles in B. Given that the first is lower than the second one, the right answer is country A.

**(b)** Which country has a comparative advantage in producing bicycles?

Answer = Given that the opportunity cost of a bicycle is 1/5 in Country B and 1/3 in Country A, the right answer is Country B.

**Q.6** Assume that a "Big Mac" hamburger costs \$3 in the United States and 2 pesos in Mexico. The indirect purchasing-power-parity exchange rate between the peso and the dollar is .....[2]  
Answer = 0.67 pesos = \$1

**Q.7** The call premium per Canadian dollar on April 19 is \$0.04, the expiration date is September 19, and the strike price is \$0.80. Ken Lee believes that the spot rate for the Canadian dollar will rise to \$0.92 by September 19. If his expectations are correct, his profit from speculating three call options (Canadian \$150,000) will be \$..... [2]

Answer = Buy call options on March 19	-\$0.04
Exercises the option on September 19	-\$0.80
Sell the pounds on September 19	+\$0.92
Net profit as of September 19	+\$0.08

Net profit for three contracts = Canadian \$150,000 x \$0.08 = \$12,000

**Q.8** Would each of the following groups be happy or unhappy if the U.S. dollar appreciated? Explain. Why? [2+2]

**(a)** U.S. export companies.

Answer = U.S. export companies would be unhappy if the U.S. dollar appreciated because their export prices would be higher in terms of foreign currencies, which will reduce their sales

**(b)** An American firm trying to purchase property overseas.

Answer = An American firm trying to purchase property overseas would be happy if the U.S. dollar appreciated because it would get more units of the foreign currency and could thus buy more property.

## **PART – II [36 Marks]**

**Q.9** Comment on the following statement: "The circular-flow diagram implies that households' spending on goods and services in product markets equals the income they earn from providing factors of production in factor markets." [5]

Answer = This is true. In the circular-flow diagram, households' spending for the goods and services they purchase is linked to the income they earn from providing factors of production. For household members to earn income to buy the goods and services they want, they must first sell their resource services to firms who purchase these services in factor markets. The market value of factor services determines the income resource owners receive.

**Diagram of circular flow of income and equation**

**Diagram of factor market and product market**

**Q.10** Elaborate the components of balance of payments. What is the difference between balance of payments and balance of trade? [5]

**Components of Current account:**

1. Exports and Imports of visible items or goods
2. Invisible items –
  - a. Transportation
  - b. Insurance
  - c. Travelling – Tourists in connection with business, health, education, pleasure
  - d. Government transactions/GNIE – Maintenance of foreign embassies, diplomatic missions and offices of international/regional institutions in India
  - e. Transfers – Donations, gifts, remittances for family maintenance
  - f. Investment income – Receiving income or income earned by foreigners in the form of rent, interest, profit and dividend

**Components of Capital Account:**

1. Foreign Investment – FDI & Portfolio investment
2. External Assistance – Aid, multilateral and bilateral loans
3. Commercial Borrowings - Medium/long term loans
4. Short-Term Loans - Maturity of less than one year
5. Banking Capital
6. Rupee Debt Service
7. Other Capital - Subscription to international institutions, quota payments to IMF

**BoP** = Receipts from abroad – Payments from abroad

**BoT** = Export of visible goods – Import of visible goods

**Give data related to BoP / trade**

**Q.11** Explain the various types of price indexes used in the Indian economy. [5]

**Price Index:**

1. Consumer Price Index (CPI) – Movements in consumer prices or retail prices are captured in the CPI – CPI (IW), CPI (AL), CPI (Rural/Urban/Combined)  
Consumer Food Price Index (CFPI) for all India Rural, Urban and Combined are also being released from May 2017 onwards

**Discuss weights of CPI basket and current data**

2. Wholesale Price Index (WPI) – It measure the movements in the wholesale prices.  
WPI Food Index will be compiled to capture the rate of inflation in food items from May 2017 onwards

**Discuss Headline inflation and core inflation WPI**

**Discuss weights of CPI basket and current data**

3. GDP Deflator – It shows the cost of purchasing the items included in the GDP during the period relative to the cost of purchasing those same items during the base year.

**Q.12** Is there any relation between inflation and business cycles? Explain with a diagram. [5]

Depression = Deflation

Recovery = Reflation

Expansion / prosperity = Inflation

Recession = Disinflation

**Draw diagram and show the inflation in different phases of business cycle.**

**Q.13** “Although India and China have different economic-political systems but they are equally affected by US recession”. Discuss. [5]

Global recession originated in the US in the later half of 2008

**Give a background of what led to Sub-prime crisis**

**India** – Democracy and mixed economic system tilted in favor of socialism

India – Indian companies acquired 143 US firm, 94 companies in 2007-08 and 50 companies in 2008

Other side, Indian financial markets had come under heavy pressure, decline in exports

Announced Fiscal package amounting 3% of GDP – Reduction in interest rate and excise duties

**Present growth rate** - India's GDP in Q2 2019-20 down to 4.5% from 5% in Q1

The GDP growth seen in the last quarter was slowest in more than six years.

The low rate of expansion was mainly on account of a weak manufacturing, falling consumer demand and private investment, and a drop in exports due to a global slowdown.

**China** – Communist system and adopted a mixed economic system

Decline in growth rate along with decline in exports and loss of jobs

Announced stimulus package of \$587 billion for labour intensive infrastructure projects -

Reduced the bank rate in Nov. 2008

**Present growth rate** - Growth slowed to 6.0% in the third quarter (2019). China's slowest GDP gain in at least 27 years.

**Q.14** There is no long-term trade-off between the rate of inflation and the rate of unemployment. Discuss. [5]

British economists, A. W. Phillips in 1958 on the basis of data from U. K. for 100 years drawn a conclusion that, there is inverse relationship between rate of unemployment and rate of inflation.

This indicates a trade-off that, for reducing unemployment, price in the form of a higher rate of inflation has to be paid, and for reducing the rate of inflation, price in terms of a higher rate of unemployment has to be borne.

During 1971-91 the Phillips curve analysis collapsed.

In these two decades period in USA, rates of both inflation and unemployment increased, i.e. a high rate of inflation was associated with a high rate of unemployment rate, which shows the absence of trade off.

This is known as shift in Phillips curve.

The long run Phillips curve is a vertical straight line showing no trade off exists between inflation and unemployment in the long run.

**Draw diagram**

**Q.15** Write short note on the following: [3x2=6]

**(a) Revenue expenditure and capital expenditure**

Refers to the expenditure of the government that neither create assets of the government nor reduces the liability of the government.

Example - Salaries of government employees, interest payment on loan taken by the government, pension, subsidies, grants etc.

Revenue expenditure > capital expenditure

Capital expenditure = It refers to the expenditure which leads to creation of assets and reduction in liabilities

Ex - Expenditure incurred on construction of building, roads, bridges, advancing loans etc.

**Give some data related to revenue and capital expenditure**

**(b) Revenue receipts and capital receipts**

These are receipts of the government that neither reduces assets of the government nor create any corresponding liability of the government.

Revenue receipts consist of:

- Tax Revenue – Direct tax and indirect tax
- Non-Tax Revenue – Commercial, administrative, gifts and grants, others.

**Give some data related revenue receipts / taxes**

Capital receipts = Those receipts that lead to a reduction in the assets or an increase in the liabilities of the government.

- Disinvestment of Public sector units - By this government assets are reduced.
- Recovery of loans - Loans given to State and local Govts.
- Borrowings - Borrowings from the public in the form of deposits (PPF), bonds etc. It also includes external borrowings.

**Give some data related to revenue and capital receipts**