

THE AUSTRALIAN NATIONAL UNIVERSITY

2nd Assignment 2022-S2

Macroeconomic Analysis (ECON7074)

Due Date: Monday, 17 October 2022, 5:00pm

Directions:

Clearly write down on the front page your student number and your tutorial time. Do not use a cover sheet.

Please do not include the questions in your answers, just write down the answers. Submit your answers as a pdf (preferred) file using the appropriate online submission portal on Wattle. Make sure you submit it before the 5pm deadline. Text must be typed. Diagrams and algebra may be neatly hand-drawn.

There are three questions in this assignment. You must answer all three. Where appropriate, do *a little* independent research, beyond the basic material covered in the lectures. However, don't go overboard - limit your answers to each question to a maximum of one page (not counting diagrams or references).

Please make sure you read the questions carefully before attempting to answer them. Keep your answers focused and succinct. Avoid waffle. We are looking for answers that display a thorough understanding of the concepts and issues. If they support your exposition, you are welcome to include equations, graphs or tables (which do not count towards the page limit).

While you are welcome to discuss the questions with your peers, please make sure your answers are your own! We will check for plagiarism. Pay close attention to referencing, if applicable. It does not matter which referencing style you use, but you need to be consistent.

Directions: Answer all questions.

1 Question

You are central bank governor of *Economia*, a mythical country, where inflation is currently equal to 100% per month. You have been told by the government that you need to increase seignorage in order to finance additional government expenditures. Unsure how to respond, you call in your two most trusted economic advisors. Advisor 1 tells you that you ought to raise the money growth rate. The other advisor, Advisor 2, tells you that you ought to reduce the money growth rate.

(a) Explain the concept of seignorage, both in words and formally (e.g. algebraically). (5 points)

(b) Which of the two recommendations is correct when, as stated, your objective is to increase seignorage? Why? (Hint: look up the concept of the “Laffer curve” and use it to answer this question.) (7 points)

2 Question

Explain briefly how the Australian IS curve is likely to be affected in the short-run by each of the following: (3 points each)

- a) High energy prices following the Ukraine war are pushing Europe into a deep recession.
- b) Mortgage lenders raise interest rates in response to an increase in the RBA’s policy rate.
- c) The government decides to reduce the size of its armed forces from 85,000 to 55,000.
- d) There is a pandemic and house prices rise much faster than anticipated.
- e) The long-run interest rate rises.

3 Question

The following table taken from the World Economic Forum shows a ranking of the "Financial Development Index" (FDI) for the top ten countries in 2011-12:

COUNTRY/ECONOMY	2012 RANK	2011 RANK	2012 SCORE (1-7)	CHANGE IN SCORE
Hong Kong SAR	1	1	5.31	+0.15
United States	2	2	5.27	+0.12
United Kingdom	3	3	5.21	+0.21
Singapore	4	4	5.10	+0.14
Australia	5	5	5.01	+0.08
Canada	6	6	5.00	+0.14
Japan	7	8	4.96	+0.19
Switzerland	8	9	4.78	+0.15
Netherlands	9	7	4.73	+0.02
Sweden	10	11	4.71	+0.20

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What do you think is captured in the FDI? What are the benefits of financial development? Everything else equal, how would you expect these countries' economic growth rates to compare? Why? Explain. (13 points)