Bachelor of Arts Examination, 2018
(2nd Year, 4th Semester)
Economics (Honours)
Macroeconomics II

Time: 2 Hours

Full Marks: 30

Answer any two questions.

1. Consider an economy, where in a given period the stock of high-powered money was Rs.1000, currency-deposit ratio was 0.5 and CRR was zero. Banks did not hold any excess reserve. Government demonetized high value currency notes forcing a reduction in the currency deposit ratio to 0.2. How did it change the stock of money supply? Explain the adjustment process. [15]

2. a. Suppose in a given period 4 projects, P1, P2, P3 and P4, were available to the investors. If the projects were built in the given period, they would be usable only in the next period beyond which they would become useless. Each of the projects needed Rs.100 to be built. Investors expected P1, P2, P3 and P4 to yield as profit Rs. 110, Rs. 120, Rs.130 and Rs.140 respectively in the next period. Draw the marginal efficiency of capital schedule. How much investment would take place, if interest rate were 20 percent?

b. Suppose in a given economy in a given period, the aggregate production function is $Y = K^{0.5}L^{0.5}$, nominal interest rate is 0.1, expected rate of inflation is 0.05. The labour force is 100 units and the amount of capital stock existing at the beginning of the given period is also 100 units. How much investment will be planned by the producers in the given period, if they behave in accordance with the neoclassical theory of investment? [10+5]

3. How does Permanent Income Hypothesis explain the consumption-income relationship yielded by cross section budget studies? Critically evaluate this explanation. [15]