Name: Sabawoon Atif

ID # 16681

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Submitted to: Ma’am Wajeeha Amin

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**PART: A**

**MCQS**

1. Printing of money is an important function of

**(a) State bank** **(b)** Currency markets (c) Commercial banks

**(2)** Fiscal policy is based upon the ideology of

**(a)** Classical economists **(b)** Keyensian economist **(c) Modern economist**

**(3)** National Internship programe (NIP) is an example of

**(a)** Public work **(b) Public employment project** **(c)** Automatic stabilizer

**(4)** Government budget is an example of

**(a)** Monetary policy **(b)** Foreign policy **(c) Fiscal policy**

**(5)** To control inflation ,Central Banks:

**(a) Increases reserve requirement** **(b)** Decrease discount rate **(c)** Sell T-Bills

**(6) People** demand money for

**(a)** 2 reasons **(b)** 3 reasons **(c) 4 reasons**

**(7)** High inflation greatly benefited the

**(a)** Creditors **(b)** exporters **(c) Fixed assets owners**

**(8)** The amount which each bank must keep with the central bank is

**(a)** **Reserve ratio** **(b)** Discount rate **(c)** Ceiling rate

**(9)** Expansionary fiscal policy is used during

**(a)** Inflation **(b) Recession** **(c)** Depression

**(10)** Unchecked increase in money supply results in

**(a)** Deflation **(b)** Stagflation **(c) Hyperinflation**

**Part: B**

**Question: 1**

**Q1:** Differentiate between

**Disinflation and hyperinflation**

Disinflation is a decrease in general price of an economy and as a result price inflation slows down temporarily. It shows the rate of change of inflation over some time. The inflation rate is declining over time but it remains positive. It does not show the slowing down of the growth of the economy but it shows a slow in the growth rate of inflation.

**Hyperinflation**

Hyperinflation is an extreme level of inflation where the inflation rate increases above 100%. During hyperinflationary periods, the price level increases significantly per year and prices cannot be controlled. Hyperinflation happens when there exists a significant rise in money supply and no or less economic growth. So, the supply and demand for money are not in balance.

**Central bank**

A central bank is actually an important economic part of the government of a country. Likewise, it controls and manages the country's financial system. A central bank is governed by government of that country and controls entries banking system. It doesn’t interact with people directly and provide guidelines to commercial banks. Finally, It provide currency and manage money supply in the country.

**Commercial Bank**

Commercial Bank act as an agent to Central Bank. It provides banking and financial services to a large number of people and business. They act as a medium between the borrowers and savers. The Commercial Banks receive deposits from the general public and charge it on high interest to the individuals and organizations. Finally, the money it takes from its customers is deposited at its local central bank

**Demand Pull Inflation**

The demand pull inflation happens when prices rise due aggregate demand in an economy is greater than aggregate supply. This kind of imbalance result in more money chasing few goods and services. For example if someone want to purchase a new iPhone and there are only few of it its price will rise as a result. It will give rise to demand pull inflation

**Cost push Inflation**

Cost-push inflation happens when production costs for wages, raw materials is increased and aggregate supply is decreased. For example, problem in cost push inflation is that when the costs of production are when increased, the supplier forwards those costs onto consumers.

**Expansionary Fiscal Policy**

Expansionary fiscal policy is a concept that focuses on expanding the economy to stabilize repeated recession. When the government wants to increase the money supply in the economy using budgetary tools to either increase spending or cut taxes both of which can stimulate economy.

**Contractionary Fiscal Policy**

Contractionary [fiscal policy](https://www.thebalance.com/what-is-fiscal-policy-types-objectives-and-tools-3305844) happens when the government either cuts [spending](https://www.thebalance.com/current-u-s-federal-government-spending-3305763) or increase taxes. It contracts the economy so that’s why it is called contractionary fiscal policy. It reduces the amount of money available for businesses and consumers to spend. Its main goal is to reach the economy to a fit economic level.

**Open Market Operation**

It is a tool in which central banks buy and sells bonds to regulate the money supply in the economy. Open market operations are the tools that is used to reach that target rate by buying and selling securities in the open market. The central bank is able to increase the money supply and lower the market interest rate by purchasing securities using newly created money.

**Discount rate**

The discount rate refers to the interest rate charged to the commercial banks and other financial institutions for the loans they take from the Federal Reserve Bank. In addition, bank will often borrow money from one another for short term needs. The discount rate of central bank are generally high compared to other small commercial banks charging one another.

**Question: 2**

**( Part: A )**

Briefly define money and discuss few of its functions.

**MONEY:**

Money is an exchange medium for replacing goods that is widely used and accepted in transactions. Money is a set of asset basically that is generally accepted as payment for goods, services and repayment of debts. It involves the transfer of goods and services from one person/business to another.

**Functions of Money**

Money is describe in terms of the three functions  that it provides in the following

1. **Medium of Exchange**

Money is a medium of exchange to enable transactions. Without money, all transactions would have to be conducted by **barter,** which involves direct exchange of one good or service for another. The difficulty with a **barter system** is that in order to obtain a particular good or service from a supplier, one has to possess a good or service of equal value, which the supplier also desires. For example, If someone is raising horses and want to buy cows, he would have to find a person who is willing to sell his cows for his horses. Such arrangements are often difficult. But Money eliminates the need of the double coincidence of wants. In other words, in a barter system, exchange can take place only if there is a **double coincidence of wants** between two transacting parties. The likelihood of a double coincidence of wants, however, is small and makes the exchange of goods and services rather difficult. Finally, such difficulty is overcome by money as a medium for exchange.

1. **Unit of account**

The unit of account is money, providing a common scale of the value of goods and services being exchanged. Knowing the value or price of a good, in terms of money, enables both the supplier and the purchaser of the goods to make better decisions. It can also be used record debts during or after a transaction.

1. **Store of Value**

Money must hold its value over time if it is used as medium of exchange. It must be a store of value.. As a store of value, money is not unique many other stores of value exist, such as lands. During inflation the store of value will lower down.  Money is the mostly liquid asset (Liquidity measures how easily assets can be spent to buy goods and services). Money’s value can remain same over time and a better way to store wealth.

**PART: B**

How some direct instruments work as a tool of monetary policy?

**Answer:**

Monetary policy is a [central bank's](https://www.thebalance.com/what-is-a-central-bank-definition-function-and-role-3305827) policy and method that manages the amount of money supply. The money supply includes forms of credit, cash, checks, and mutual funds. The most important of these forms of money is credit. Credit includes loans, bonds, and mortgages.

1. Open Market operations are when central bank buys or sell securities.
2. Reserve Requirements allows the bank to keep money reserve in their vaults or at the central bank.
3. Discount rate is the rate at which central banks charge its members to borrow at its discount.  Banks only use this if they can't borrow funds from other banks.
4. Printing Money
5. Direct Instrumentation
6. Persuasion

**Question: 3**

**Part: (A)**

What do you mean by ***“automatic stabilizers”?*** Give some examples.

**Answer:**

**AUTOMATIC STABILIZERS:**

Automatic stabilizer are features of the tax and transfer systems that temper the economy when it overheats and stimulate the economy when it slums, without direct intervention by policy makers. It offsets fluctuations in economic activity without direct intervention by policy makers.

**For Example**

The best known automatic stabilizers are continuously graduated corporate and personal income taxes, and transfer systems such as unemployment, insurance and welfare. Automatic stabilizers are so called because they act to stabilize economic cycles and are automatically triggered without additional government actions.

**PART: B**

How inflation is measured?

**Answer:**

There are three kinds of methods used to measure inflation and which are follow as:

1. **Monetary Policy**

This measure is taken by central bank to lower the money supply. First, it sells all the bonds and securities to commercial banks and take money from them. So commercial banks are left with little money and cannot offer loans to people and business. Next, central banks also increase their interest rate for commercial banks. So commercial banks are once again cannot offer loans as they do not take loans from central banks in return on high interest rate and inflation is controlled.

1. **Fiscal Policy**

The federal government spend less and increase tax in order to control inflation in the country. First, the government lower down all the money its spending on less productive goals and increase direct taxes to reduce consumption. As a result, the demand for goods fall and inflation is controlled.

1. **Direct Meaure**

In this measure Agriculture part of a country is used to control inflation. More land can be brough under cultivation by using modern methods of technology. It provides us better quality seeds and fertilizer which are key factor for increasing productivity. Finally, its really important to make a government who can keep the prices fixed and should be strictly followed; those who violate it should be punish accordingly.

**Question: 4**

**(Part: A)**

Give some of the causes of ***cost push inflation?***

**Answer:**

**CAUSES OF COST PUSH INFLATION:**

The following are the main causes of cost push inflation

1. **Increase in cost of raw materials**

The increase in the cost of goods used in manufacturing and construction, such as raw materials. For example, if companies use steel in the manufacturing process and the price of the steel suddenly rises, companies will pass these high prices on to their customers.

1. **Increase in wages**

Increased in salaries can create cost-push inflation. So when wages increases for production employees due to an increase in minimum the wage per worker. The cost of production can rise due increase in wages. As a result, the price of product have to go up and contributes in cost push inflation.

1. **Decrease in Production**

Other reason behind cost-push inflation are often natural disasters like tsunami, earthquakes, tornadoes or political problems. If a large disaster causes damage to a production facility of factory or industry. It results in a shutdown or partial disruption of the production chain, which will definitely result in higher production cost.

1. **Imported Inflation**

Another cause is importing more and exporting less. Similarly, if a country is frequently importing goods and they are exporting less comparatively, as a result, the prices will rise which lead to cost push inflation.

1. **Indirect taxes**

When government put sales tax on certain products. It can raise the prices of goods in the market and hence can contribute in cost push inflation.

**PART:B**

Why inflation is good?

**ANSWER**:

**Reason:**

Inflation is beneficial for economy of a country when it is at a certain moderate level. It helps to boost the economy when the prices are slowly going up. It allows the customer to buy goods sooner rather than later. Inflation helps to increase production. More rupees translates to more spending, which results in aggregated demand. More demand, in turn, triggers more production to meet that demand.

Inflation also makes it easier on borrowers, who repay their loans with money that is less valuable than the money they borrowed. This encourages borrowing and lending, which again increases spending. Finally, it **removes the risk of**[deflation](https://www.thebalance.com/what-is-deflation-definition-causes-and-why-it-s-bad-3306169) by falling prices. When it happens, people wiil wait for the prices to fall before buying. It reduces back demand, and businesses reduce their inventory. As a result, factories produce less and lay off workers. Unemployment rises, leading to wage deflation. Workers have less money to spend, which reduces demand even more. It makes deflation worse and deflation have more negative effect on economy compared to inflation.

THE END