Name: Mussab Rehman
Sec: A
Reg no: 16352
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Department: BBA
Submitted to: Miss. Wajiha Amin

(Part-A)

1. a
2. b
3. b
4. c
5. c
6. b
7. c
8. a
9. b
10. c

Part-B

Q1.Differentiate between:

(a)

Disinflation:

- Reduction in the rate of inflation.
- It is economic growth, such as -5% disinflation is simply a reduction in the rate of inflation.
- It occurs when the rate at which the prices are raising is diminishing.
- It signals a slow in the growth rate of inflation.

Hyperinflation:

- An inflation is an extreme case of inflation where the inflation rate increases above 100%.
- During hyperinflationary periods, the prices level increases by about 500% to 1000% per year and prices are out of control.
- A significant rise in money supply not supported by economic growth.

(b)

Central Bank:

- Most central banks are owned and operated by the government.
- They run the country's financial system.
- Central bank officials are public officials.
- Most are independent of politicians.
- Accountability is upheld through legal stipulated checks and balances.

Commercial Bank:

- A commercial bank provides banking services to businesses, institutions and some individuals.
- Commercial bank serves individuals and business.
- Commercial banks use the central bank's money transfer wire system to move money throughout their branch system and between the bank and customers.
- Mostly work in local country yet few foreign banks are also there.

(c)

Demand Pull Inflation:

- It is a situation where the aggregate demand persistently/continuously exceeds the available supply of output at a current prices which causes the general price level to go up.

  (Demand > supply…..prices go up!)

- The Price of products increases due to high demand and less supply.
- It is associated with the boom phase of the cycle.
- Demand pull inflation is usually caused by monetary in origin.
  e.g:
  High levels of consumers spending.

Cost push Inflation:

- That case of inflation where the price level rises due to increase in cost of production.
- It occurs when cost of production are increasing.
- E.g
  A depreciation in the exchange rate.

(d)

Expansionary fiscal policy:

Expansionary fiscal policy increases the level of aggregate demand, through either increases in government spending or reductions in taxes. Expansionary policy can do this by:

- Increasing consumption by raising disposable income through cuts in personal income taxes.
- Increasing investments by raising after-tax profits through cuts in business taxes.
- Increasing government purchases through increased spending by the federal government on final goods and services.
- Used in the recession period when the economy slows down.
- Expands the amount of currency in the economy.

Contractionary fiscal policy:

- It decreases the level of aggregate demand by decreasing consumption, decreasing investments.
- Decreasing government spending, either through cuts in government spending or increases in taxes.
- Used during inflation period.
- Reduces the amount of currency in the economy.

(e)

Open Market operation:

- The Federal Reserve buys and sells government securities to control the money supply and interest rates. This activity is called Open Market operations. To increase the money supply, the Fed will purchase bonds from banks, which injects money into the banking system.
- Central bank sell and purchase the securities to the public, govt., businesses etc.
  When they buy government bonds, the money supply increases
  When they sell government bonds, the money supply decreases

Discount rate:

- The *discount rate* is the interest rate the Central Bank(State bank) charges commercial banks and the government for loans

  Increasing the discount rate decreases the money supply.
  Decreasing the discount rate increases the money supply

Q2. Define money and discuss few of its functions.

Money:

- Money is simply everything which the people use for exchange.

  OR

- The set of assets that people regularly use to buy goods &services from other people.

Functions of money:

Medium of exchange:
Item buyers give to sellers when they want to purchase goods &services.

Unit of account:
The yardstick people use to post prices and record debts

Store of value:
An item people can use to transfer purchasing power from the present to the future

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

Ans: Some direct instruments work as a tool of monetary policy is as follows:

1. Ceilings on interest rates:
A level or restriction imposed by the central bank above which rate can’t be increased.

- Create excess demand for credit.
- Prone to abuse.
- Inefficient and unfair.

2. Quotas on credit:

- A maximum or minimum limit on quantity. Applied to imports, a quota designates the maximum quantity of a product that may be brought into a country during a specified period of time. Quotas can have significant impact on certain industries and companies. The establishment of a quota or a change in an existing quota can influence the price of the affected firm's securities

Q3: What do you mean by “automatic stabilizers”? Give some examples.

Automatic stabilizers:

- **Automatic stabilizers** are a type of fiscal policy designed to offset fluctuations in a nation's economic activity through their normal operation without additional, timely authorization by the government or policymakers.
- It automatically stabilizes the economy.
- Automatic Stabilizers stimulate AD during periods of recession and dampen AD during periods of expansion.
- They do not require yearly government action to operate.

Examples of Automatic stabilizers:

- Progressive income tax
- Unemployment insurance
- Welfare spending

(b) How inflation is measured?

Measuring inflation is not an easy task. Number of economy goods is put together into what is known as "market basket." The cost of this basket is compared over time. This results in a price index, which is the cost of the market basket today as a percentage of the cost of that identical basket in the starting year.

Consumer Price Index (CPI):

- CPI is commonly used for measuring the inflation.
- A measure of price change in consumer goods and services such as gasoline, food, clothing and automobiles.
- CPI measures the price change from the perspective of the purchaser.
- The Consumer Price Index (CPI) uses a "basket of goods" approach that aims to compare a consistent base of products from year to year, focusing on products that are bought and used by consumers on a daily basis. The price of your milk, eggs, toothpaste and a hair cut are all captured in the CPI.
- The market basket is updated every few years to remove goods and services that might have become obsolete or irrelevant.
- Percentage changes in CPI measures inflation.

Q4 (a): Give some of the causes of cost push inflation?

Following are the main causes of cost push inflation:

Increase in cost of raw materials:
When the prices of raw materials increases this increase the cost of production of the producer and the producer increases the price of the

Increase in wages:
The rise in wages increases the cost of production which increases the price of the product.

Imported inflation:
Sometimes a country has to face inflation because it imports goods from other countries at continuously rising prices.

Decrease in Production:

Changes in the volume of production, has inverse effect on price level. If in some situation such as floods, war or political disturbances, production of goods fall, price tends to rise.

Indirect taxes:

Indirect taxes also push up prices of goods. when the government imposed the sales tax on the commodities like oil, gas, electricity, telephone, food products etc the prices goes up in the market.

(b) Why inflation is good?

- Economists generally argue that some inflation is a good thing. A healthy rate of inflation is considered to be approximately 2-3% per year. The goal is for inflation (which is measured by the Consumer Price Index, or CPI) to outpace the growth of the underlying economy (measured by Gross Domestic Product, or GDP) by a small amount per year.
- A healthy rate of inflation is considered a positive because it results in increasing wages and corporate profitability and keeps capital flowing in a presumably growing economy.
- Small amounts of inflation encourage consumption. For example, if you wanted to buy a specific item, and knew that the price of it would rise by 2-3% in a year, you would be encouraged to buy it now. Thus, inflation can encourage consumption which can in turn further stimulate the economy and create more jobs.
- However, as some inflation may be good on macroeconomic level, on microeconomic level it might be quite bad for someone (individuals my not like higher prices)