Name	Faisal Badori	Course	Macroeconomics
Roll	16687	Teacher	Miss. Wajeeha Amin
Program	B.B.A	Section	B

(A) PART:

MCQ'S:

1 = a

2 = b

3 = b

4 = c

5 = c

6 = b

7 = c

8 = a

9 = b

10 = c

(B) PART:

Answer of question number (1)

Differentiate between:

- ## Disinflation and hyperinflation:

Disinflation:

Disinflation is a condition where inflation is still positive, but the rate of inflation is decreasing.
For example, from +3% to +2%
Whereas deflation is negative economic growth, such a -5%, disinflation is simply a reduction in the rate of inflation, such as the inflation rate going from 9% one year to 7% the next year. It occurs when the rate at which the prices are raising is diminishing.
It is important to note that it does not signal the slowing down of the growth of the economy; it signals a slow in the growth rate of inflation.

Hyperinflation:

is unusually rapid inflation, typically more than 50% in a single month. This inflation can lead to the breakdown of a nation's monetary system or even its economy. One of the most notable examples of hyperinflation occurred in Germany in 1923, when prices rose 2,500% in one month! Hyperinflations have also famously occurred in Zimbabwe, hungry and Argentina.

Hyperinflation is an extreme case of inflation where the inflation rate increases above 100%.
During hyperinflationary periods, the price level increase by about 500% to 1000% per year.
Here, prices cannot be controlled.
Hyperinflation happens when there exists a significant rise in money supply not supported by economic growth. As a result, the supply and demand for money are at a disequilibrium.

- ## Central bank and commercial bank:

Central bank:

A central bank is a financial institution given privileged control over the production and distribution of money and credit for a nation or a group of nations. In modern economies, the central bank is usually responsible for the formulation of monetary policy and the regulation of member banks .
Central banks are inherently non-market-based or even anti-competitive institutions.

Commercial bank:

A commercial bank is a type of bank that provides services such as accepting deposits, making business loans, and offering basic investment products that is operated as a business for profit.

It can also refer to a bank, or a division of a large bank, which deals with corporations or large/middle-sized business to differentiate it from a retail bank and an investment bank.
Commercial banks include private sector banks and public sector banks.

- ## Demand pull and cost push inflation:

Demand pull inflation:

Demand-pull inflation is the upward pressure on prices that follows a shortage in supply. Economists describe it as "too many dollars chasing too few goods."
Demand-pull inflation is a tenet of Keynesian economics that describes the effects of an imbalance in aggregate supply and demand. When the aggregate demand in an economy strongly outweighs the aggregate supply, prices go up.
This is the most common cause of inflation.

cost push inflation:

Cost-push inflation occurs when we experience rising prices due to higher costs of production and higher costs of raw materials. Cost-push inflation is determined by supply-side factors, such as higher wages and higher oil prices.
Cost-push inflation is different to demand-pull inflation which occurs when aggregate demand grows faster than aggregate supply.
Cost-push inflation can lead to lower economic growth and often causes a fall in living standards, though it often proves to be temporary.

- ## Expansionary and contractionary fiscal policy:

Expansionary fiscal policy:

Expansive Fiscal policy supports Aggregate Demand growth and therefore the growth of total output.
Expansionary fiscal policy is when the government expands the money supply in the economy using budgetary tools to either increase spending or cut taxes—both of which provide consumers and businesses with more money to spend.

Contractionary fiscal policy:

Restrictive fiscal policy is aimed to lessen the inflation rare by the means of limiting both the aggregate demand and supply.
Contractionary fiscal policy is a form of fiscal policy that involves increasing taxes, decreasing government expenditures or both in order to fight inflationary pressures.
Due to an increase in taxes, households have less disposal income to spend. Lower disposal income decreases consumption.

- ## Open market operation and discount rate:

Open market operation:

Central bank conducts open market operation when they buy or sell the government securities like bond, T-bills etc.… in market.
The parties to which the central bank sell or from which they purchase are general public, govt., business etc.
When they buy government bond, the money supply increase.
Or when they sell government bond, the money supply decrease.
Foreign exchange market intervention also effects the money supply.

Open market operations (OMO) refers to when the Federal Reserve purchases and sells U.S. Treasury securities on the open market in order to regulate the supply of money that is on reserve in U.S. banks, and therefore available to loan out to businesses and consumers. It purchases Treasury securities to increase the supply of money and sells them to reduce the supply of money.

Discount rate:

Discount rate is the interest rate the central bank (state bank) charges the commercial bank and the government for loans.
Increasing the discount, the money supply.
Decreasing the discount rate increases the money supply.
The discount rate is the interest rate Reserve Banks charge commercial banks for short-term loans. Federal Reserve lending at the discount rate complements open market operations in achieving the target federal funds rate and serves as a backup source of liquidity for commercial banks.

Question 2 Part “A”

Definition of money and it few functions:

Money is simply everything which the people use for exchange.
The set of assets that people regularly use to buy goods and services from other people.
Money is an economic unit that functions as a generally recognized medium of exchange for transactional purposes in an economy. Money provides the service of reducing transaction cost, namely the double coincidence of wants. Money originates in the form of a commodity, having a physical property to be adopted by market participants as a medium of exchange. Money can be: market-determined, officially issued legal tender or fiat moneys, money substitutes and fiduciary media, and electronic cry2ptocurrencies.

Functions of money:

1) **Medium of exchange:** Money allows goods and services to be traded without the need for a barter system. Barter systems rely on there being a double coincidence of wants between the two people involved in an exchange.

2) **Store of value**: This can refer to any asset whose "value" can be used now or used in the future i.e. its value can be retrieved at a later date. This means that people can save now to fund spending at a later date.

3) **Unit of account:** This refers to anything that allows the value of something to be expressed in an understandable way, and in a way that allows the value of items to be compared.

4) **Standard of deferred payment:** This refers to the expressing of the value of a debt i.e. if people borrow today, then they can pay back their loan in the future in a way that is acceptable to the person who made the loan.

Question 2 Part "B"

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

A. 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.

B. 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

Question 3 Part "A"

Automatic stabilizers:

Automatic stabilizers are mechanisms built into government budgets, without any vote from legislators that increase spending or decrease taxes when the economy slows. During a recession, automatic stabilizers can ease households' financial stress by decreasing their tax bills or by boosting cash and in-kind benefits, all without changes in the tax code or any other new legislation.

Example:

High Growth: In a period of high economic growth, automatic stabilizers will help to reduce the growth rate. With higher growth, the government will receive more tax revenues – people earn more and so pay more income tax (note the tax rate doesn't change, the amount received just becomes higher). With higher growth, there will also be a fall in unemployment so the government will spend less on unemployment benefits. In a period of high growth ceteris paribus government borrowing will fall.

Recession: In a recession, economic growth becomes negative. However, automatic stabilizers will help to limit the fall in growth. With lower incomes, people pay less tax, and government spending on unemployment benefits will increase. This increase in benefit spending and lower tax collection helps to limit the fall in aggregate demand. In a recession ceteris paribus government borrowing will increase.

Question 3 Part “B”

Measuring of inflation:

Measuring inflation is a difficult problem for government statisticians. To do this, a number of goods that are representative of the economy are put together into what is referred to as a "market basket." The cost of this basket is then 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.

- One of the most commonly used measure for inflation
- A measure of price changes in consumer goods and services such as gasoline, food, clothing and automobiles. The CPI measures 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 haircut 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.

Question 4 Part “A”

Causes of Push inflation:

- **Increase in Cost of Raw Materials:**

  When the prices of raw materials increase this increase the cost of production of the producer and the producer increases the price of the product.

- **Increase in wages:**

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

- **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 falls, prices tend to rise.

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

- **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.

Question 4 Part “B”

Why the inflation is good?

Inflation is good when it is mild. There are two situations where this occurs.

a) When inflation makes consumers expect prices to continue rising. When prices are going up, people will buy now rather than pay more later. This increases demand in the short term. As a result, stores sell more and factories produce more now. They are more likely to hire new workers to meet demand. It creates a virtuous cycle, boosting economic growth.

b) When it removes the risk of deflation, that’s when prices fall when that happens, people wait to see if prices will drop more before buying. It cuts 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. Businesses lower their prices. That makes deflation worse. For this reason, deflation is even more corrosive to economic growth than inflation.
Prices fell 10% during the worldwide Great Depression.