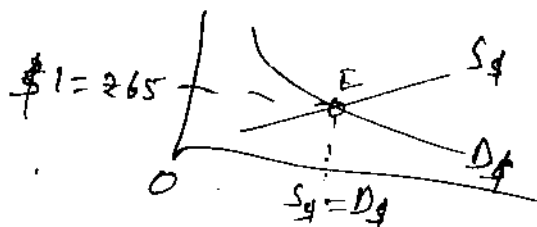


① Set 3

Q.1

① Determination of real exchange rate:-

Solu! Demand & Supply factors of foreign exchange



① Role of Govt, ② Role of Central bank, ③ Role of speculators apart from export & import factors.

② Equilibrium GDP & Trade imbalance

Solu!- Define GDP, Equilibrium GDP

Define BOT & BOP

Define relations between GDP & Trade

GNP equations with foreign-trade

③ Fiscal Policy and Exchange rate policy in fixed exchange rate system.

Solu!- Define fiscal policy

Define Exchange rate policy

Fixed Exchange Rate System - till 1970's  
(Gold Standard, \$ US\$ link)

Effect of changes in fiscal policy in fixed exchange rate.

①

# Uncovered Interest rate Parity (UIP)

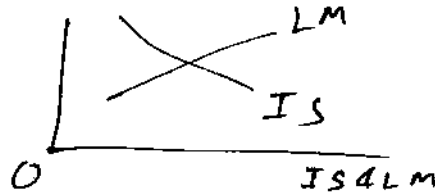
Q. 2

(a) The Combined IS, LM and UIP model

Solu! Define & Draw IS curve

Define & Draw LM curve

show combined Equi of IS, LM & UIP curve



b) Fiscal and monetary policy under fixed exchange rate.

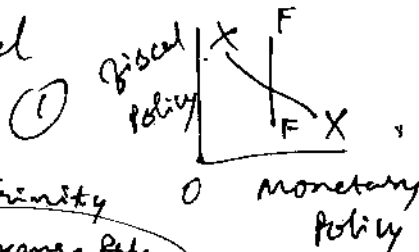
Solu!- Define fiscal & monetary policy

Describe fixed exchange rate system

show adjustment of fiscal and monetary policy under fixed exchange rate.

c) The Mundell - Fleming trilemma

Solu!- Describe & Draw Mundell - Fleming model



(1) Impossible Trinity

Fixed Exchange Rate

Independent monetary Policy

Free capital flow

(2)

(3) Possible Trinity

Managed Exchange Rate

Co-op monetary Policy

Managed Capital Flow

GDP Calculations.

Solu!:- Define BOT, BOP, Surplus & Deficit

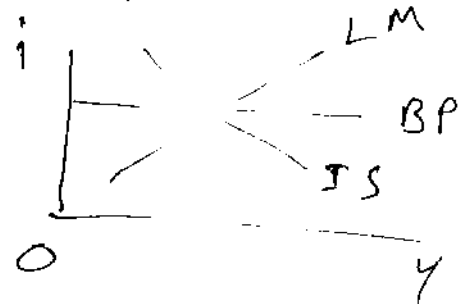
Give equations for GDP/GNP Calculations.

b) The LM equation for the open economy

Solu!:- Derivation of LM curve & equation in open economy.

changes in money supply due to changes in foreign exchange reserve.

IS-LM-BP model



(c)

Q. 5

(a) Export &amp; import function

Solu:- Describe export & import factors  
changes in GNP due to trade

(b) Uncovered interest parity and  
its implications for exchange rate  
determination

Solu:- Describe determination of exchange  
rate.

effect of changes in interest rate  
on exchange rate.

Q. 3

(a) Merits and Demerits of flexible  
adjustment of BOP

Solu:- Define flexible exchange rate

Merits — at least 5 points

Demerits — at least 5 points.

Q3. a) Merits and demerits of Flexible Exchange rates.

Merits: maintains BOP eq<sup>m</sup>, promotes economic stability, monetary autonomy, stabilises speculation and smooths adjustment of BOP.

Demerits: Discourages investment and borrowings, frequent changes in macro economic policies, irrational speculation, low international cooperation etc.

b) Floating exchange rate and automatic adjustment of BOP. Disequilibrium in BOP is set right by appreciation or depreciation of currency. Draw and explain.

c) Exchange rate crisis and its impact.  
Crisis in exchange rates due to volatility leads to trade crisis, currency crisis and banking crisis.

4 a) Gold Standard during Depression

During the world wars, exchange rates were fluctuating. Hence efforts were made to return to the gold standard. But during Depression it collapsed and was abandoned.

b) Bretton Woods system.

In July 1944, allied countries met in Bretton Woods in U.S.A to avoid the rigidity of the gold standard and chaos of the 1930s in international trade and finance. This gave way to the Bretton Woods system where the exchange rates between countries were pegged in terms of gold or U.S. dollar at \$35 an ounce of gold. The liquidity mechanism was looked into. SDRs were created. This system worked smoothly from 1950s to mid 1960s. (PTD)

1) Global financial crisis: Subprime lending, housing bubble, easy credit creation, weak and fraudulent underwriting practices, predatory lending, deregulation etc led to the crisis. Explain.

5. c) Hard peg and managed flexibility

Hard peg - fixed exchange rate. rigid.

Managed flexibility is adjustable peg and interference by the monetary authority.

d) Significance of Maastricht Treaty - Birth of European Union and Euro. Conditions to be followed by members of EU. Discuss.

---