

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF ARTS

SECOND YEAR EXAMINATION IN ARTS (ECONOMICS) – 2017/2018
END OF THE SECOND SEMESTER

ECN 2223 MACROECONOMIC ANALYSIS

Time Allowed: Two (02) Hours
Answer 04 questions.

- (1) A sudden increase in international interest rate resulted in a net capital outflow of a small country with an open economy. As the balance of payments position deteriorated, exchange rate was under pressure. The Central Bank had two options as either to defend the exchange rate intervening in the foreign exchange market or to let the exchange rate depreciate allowing for an automatic adjustment mechanism.
- (i) Show the loss of investor confidence in the foreign exchange market using IS-LM-BOP framework and, its impact on the balance of payments. (10 Marks)
- (ii) Out of the two options available for the government to correct the BOP imbalance, which option do you advise for and why? (15 Marks)
- (2) Assume a country that has already faced with a balance of payments deficit. The government that seeks to strengthen its political power begins to increase public spending financed by printing more money. Answer the following questions, assuming that the country has an imperfect and weaker capital mobility and a fixed exchange rate system:
- (i) What is the impact of the above policy on the country's external finance position? (10 marks)
- (ii) What would be the policy outcome, when the Central Bank decides to defend the fixed exchange rate? Would it have been better if the Central Bank had maintained exchange rate flexibility? (15 marks)
- (3) Although monetarist analysis on achieving macroeconomic objectives started to gain momentum since the 1950s, it did not translate itself into a set of policies until the policy trust on Keynesianism declined since the 1970s.
- (i) What factors caused the rise and fall of Keynesian macroeconomic policies? How does the fall in Keynesianism open the space for the adoption of monetarist policies? (10 marks)

- (ii) What is the Monetarist policy advocacy for growth and stability? Do you think whether Keynesian and Monetarist policies are alternative policy choices as many would perceive or just the need of the time? (15 marks)
- (4) (i) Explain the Classical Quantity Theory of Money (QTM). What is the policy guidance that is emanating from the QTM? (10 marks)
- (ii) How did the Cambridge version of money demand originate from the QTM? What are the macroeconomic policy implications emanating from the Cambridge version of money demand, compared with its Keynesian version? (15 marks).
- (5) In Monetarist view, excessive money growth is inflationary and, this inflationary effect is disproportionately larger than the rate of money growth.
- (i) What is excess money growth? How does it lead to an increased aggregate demand through substitution effects in the assets portfolio in the economy? (10 marks)
- (ii) Why the resulting inflation is spiral and disproportionately larger than money growth? (15 marks)
- (6) (i) Economic recessions caused by adverse demand shocks are accompanied by deflationary pressure on prices, while those recessions caused by adverse supply shocks are accompanied by inflationary pressure on prices. Explain. (10 marks)
- (iii) Is there a role for the government in recessions? How does the role of the government differ between the two types of recessions mentioned above? (15 marks)
- (7) The recent global financial crisis resulted in a massive loss of world GDP in 2009 as the rate of economic growth turned to be negative. However, the loss has been mostly in the high-income OECD countries, while most of the Asian countries continued to grow in the midst of the crisis. Discuss the underlying reasons for the above difference between the high-income OECD countries and the developing Asian countries. (25 marks)
