Department of Economic Science

IISER Bhopal

Mid-Semester Examination

Principle of Economics 2 - ECO 102

Time: 2 Hours Total Marks: 100

1. (20 marks). Renewed tensions in the Middle-East threaten to push the oil price upwards. What impact might a new increase in oil price have on the aggregate price level and on the real GDP in your country? Illustrate your answer with aggregate demand and aggregate supply curves. What could your central bank do, it it desired to maintain aggregate output as its actual level?

2. (10 marks). Use aggregate supply and aggregate demand curves to illustrate the effect the mild monsoon season had on the rice crop in India. Explain what effect this had on the levels of aggregate output and inflation in India.

3. (20 marks) In Solow model, describe the effect (using graph) of increase in saving rate on economic growth and output per worker.

4. (20 marks) Suppose reserve bank of India sells bonds in the open market. How this will impact lending by private banks when they have extra reserves? What will happen when private banks don't have extra reserves?

5. (20 marks) Consider following consumption function

$$C = a + b\,(Y - T)\,.$$

The equilibrium condition is described as

$$Y = C + I + G.$$

where Y is total output, I is investment and G is government expenditure. Derive the government expenditure multiplier.

6. (10 marks) By using the equilibrium condition Y (Output) $= AE$ (Planned Aggregate Expenditure), show graphically the effect of exogenous increase in investment (I) on output (Y). Assome that $C = 50 + 0.75Y$.