

JK LAKSHMIPAT UNIVERSITY, JAIPUR
INSTITUTE OF MANAGEMENT

End-Term, May 2025
BBA, Semester II, 2024-25

EP1102: Economics-II

Time: 2.5 hours

Roll No.

Max. Marks: 50

Instructions to students: -

1. Read the entire question paper before beginning.
2. Write your **Roll No.** clearly on the question paper before starting.
3. Only **simple calculators** are allowed; no other digital devices are permitted.
4. If there are options provided for a question, you must answer only **one** question out of the provided options.
5. Clearly indicate the question number you have chosen.
6. *Note:* Irrelevant or redundant answers will be penalized.

1. (10 marks) Explain the concept of the yield curve and its significance in predicting economic recessions. How did the yield curve behave during the Great Recession, and what economic information can be derived from an inverted yield curve? (CO 1,5)

OR

1. (10 marks) In 2023, India's debt-to-GDP ratio reached approximately 83%, up from around 75% before the COVID-19 pandemic. The government is currently running a primary deficit while the economy is projected to grow at 6% annually in real terms with interest rates on government debt around 7%. Using the debt sustainability framework discussed in class, find the upper limit of the primary budget balance (as a % of GDP) of the Indian government to have a sustainable debt (i.e., debt-to-GDP ratio does not grow). (CO 1,6)

2. (10 marks) Describe the concept of a liquidity trap and its relevance during the Great Recession. Using the Fisher equation and the zero lower bound constraint, explain why conventional monetary policy becomes ineffective in such situations and how this can lead to a deflationary spiral. Include relevant equations in your answer. (CO 1,4,5)

OR

2. (10 marks) The Finance Minister of India has announced a Rs 2 lakh crore tax cut by reducing the tax rates aimed at boosting consumption during an economic slowdown. Critics argue this will worsen the fiscal deficit without significantly stimulating growth. Using the fiscal policy multiplier framework, show how it impacts the multiplier (assume earlier tax rate was 30% and now it is 20% and marginal propensity to consume (MPC) is 70%). If the consumers expect that the current tax cut will be financed by future tax increases (Permanent Income Hypothesis) and they respond by consuming less and saving more today (by reducing MPC to 0.4), how the multiplier changes? Which according to you is more valid scenario - the one without any change in MPC or the Permanent Income Hypothesis one in which MPC changes? (CO 1,2,3)

	Eastland	Westland
Labour Force	1000	800
Kilograms of wheat produced by 1 worker per day	200	80
Smartphones produced by 1 worker per day	5	8

3. (6 marks) Consider two countries, Eastland and Westland, that produce only two goods: smartphones and wheat. Above table shows the size of labour force and productivity in each country. Assume that the currency in both the countries is wheat and that a consumer spends 40% of their income on smartphones and 60% on wheat. (CO 1,3)

(a) (2 marks) Calculate which country has an absolute advantage in producing each good, and which country has a comparative advantage in producing each good.

(b) (4 marks) Under autarky (no trade):

- (1 marks) Calculate the price of a smartphone (in kilograms of wheat) in each country.
- (1 marks) Calculate the wage rate (in kilograms of wheat) in each country
- (1 marks) Calculate the consumption of wheat and smartphones per person in each country.
- (1 marks) Calculate the total production of wheat and smartphones in each country.

4. (14 marks) For the same economy as given in Question 3: (CO 1,3,6)

(a) (12 marks) Under free trade:

- (1 marks) Determine which good each country will specialize in producing.
- (1 marks) Calculate the total production of wheat and smartphones in each country.
- (3 marks) Calculate the world price of a smartphone (in kilograms of wheat).
- (2 marks) Calculate the new wage rates in both countries (in kilograms of wheat).
- (3 marks) Calculate the consumption of wheat and smartphones per person in each country.
- (2 marks) Calculate the volume of trade (how much wheat is exchanged for how many smartphones).

(b) (2 marks) Calculate the welfare gains from trade for each country by comparing per capita consumption under autarky (Q. 3) versus free trade. Express the gains as percentage increases in consumption of each good.

5. (10 marks) In an article which appeared in The Economist's April 2025 issue, it states: "Since coming into office Mr Milei (Argentine President) has devalued the peso, but inflation has not fallen quickly enough, leaving the peso overvalued again." Using concepts from international finance, explain what this statement means regarding the relationship between currency devaluation, inflation, and currency overvaluation. Analyze how this situation affects Argentina's international competitiveness and balance of trade. Discuss how Argentina's monetary policy choices might be constrained by the policy trilemma, and what options President Milei might consider to address the ongoing currency challenges. (CO 1,7)

OR

5. (10 marks) In 2018, Turkey experienced a severe currency crisis with the lira depreciating by over 40% against the US dollar. Despite rising inflation, President Erdogan opposed interest rate hikes and pressured the central bank to maintain low rates until September 2018. Using the open-economy macroeconomic framework, analyze how this monetary policy stance affected the lira's exchange rate and Turkey's net exports, inflation, and output gap. If the central bank had instead raised interest rates significantly earlier in the crisis, how would this have affected these economic variables? Reference the relationship between interest rates, exchange rates, and the trade balance. (CO 1,5,6,7)