MGT411 Subjective Material

Question No: 49 (Marks: 3)
What is the effect of an increase in potential output on inflation and output?
Solution:-

The Effects of an increase in potential Output on Inflation and Output
An increase in potential output shifts the LRAS curve to the right. In the short run, current output remains unchanged. But since current output is now below potential output, the resulting recessionary gap places downward pressure on inflation and output eventually begin to rise.

Question No: 50 (Marks: 3)
Give an account of different components of aggregate demand?
Solution:-
Aggregate demand is divided into four components:

1. Consumption,
2. Investment,
3. Government purchases,
4. Net exports

Investment is the most important of the components of aggregate demand that are sensitive to changes in the real interest rate. Consumption and net exports also respond to the real interest rate;
Aggregate Govt.'s Net Demand = Consumption + Investment + Purchases + Exports

Question No: 51 (Marks: 5)
Give brief explanation of the following.
a)What is Target funds rate?
Solution:-
The target federal funds rate is the central bank's primary policy instrument. It is Interest rate charged on overnight loans between banks

b) How it is controlled?
Solution:-

The central bank chooses to control the federal funds rate by manipulating the quantity of reserves through open market operations: the central bank buys or sells securities to add or drain reserves as required.

c)What will be the impact of target federal rate on economy?
Solution:-
<u>Changes interest rates throughout the economy</u>
When central bank targets the quantity of reserves, a shift in reserve demand causes the market federal funds rate to move. An increase in reserve demand forces the interest rate up, while a fall in reserve demand forces the interest rate down.

Question No: 52 (Marks: 5)

A well-designed policy framework helps policymakers establish credibility. Discuss the principles of central bank design.
Solution:-
A well-designed policy framework also helps policymakers establish credibility.
The Principles of Central Bank Design
- **<u>Independence:</u>**

To keep inflation low, monetary decisions must be made free of political influence
- **<u>Decision making by committee:</u>**

Pooling the knowledge of a number of people yields better decisions than decision making by an individual
- **<u>Accountability and transparency:</u>**

Policy makers must be held accountable to the public they serve and clearly communicate their objectives, decisions and methods
- **<u>Policy framework:</u>**

Politicians must clearly state their policy goals and the tradeoffs among them

Question No: 53 (Marks: 5)

"Monetary policy makers react to changes in current inflation by changing the real interest rate". Discuss.
Solution:-
Monetary policy makers react to changes in current inflation by changing the real interest rate. Increases in current inflation lead them to raise the real interest rate, while decreases lead them to lower it. The monetary policy

reaction curve is located so that the central bank's target inflation is consistent with the long-run real interest rate, which equates aggregate demand with potential output.
When policymakers adjust the real interest rate they are either moving along a fixed monetary policy reaction curve or shifting the curve. A movement along the curve is a reaction to a change in current inflation; a shift in the curve represents a change in the level of the real interest rate at every level of inflation.

Question No: 49 (Marks: 3)

What are the factors that affect the quantity of money?

Question No: 50 (Marks: 3)

Discuss the impact of rise in real interest rate on the component of aggregates demand.

Components of Aggregate demand	**Effects of a rise in the real interest rise**	**Impact on the component of Aggregate demand**
Consumption		
Investment		
Net exports		

Question No: 51 (Marks: 5)

Discuss the impact of inflation shock on output and inflation.

Question No: 52 (Marks: 5)

Write down the unique role of depository institutions.

Question No: 53 (Marks: 5)

Which relationship is shown by the monetary policy reaction curve?

What will be the change in monetary policy reaction curve if the given factors change?

a. An increase in the Central Bank's Inflation Target

b. An increase in the Long-run real interest rate

Question No: 50 (Marks: 3)

Give an account of different components of aggregate demand?

1. Consumption:
2. Investment:
3. Government purchases:
4. Net exports:

Question No: 49 (Marks: 3)

Discuss velocity both in long and short run.

Question No: 50 (Marks: 3)

What is the effect of an increase in potential output on inflation and output?
Answer:- Increase in potential output shifts long run aggregate supply curve to right, this shift has no impact on short run aggregate supply curve so inflation and output remains unchanged. But in long run now as potential output is increased so current output will be below potential output creating recessionary out gap causing inflation to fall and output begins to rise.

Question No: 51 (Marks: 5)

If banks offers Mr. A a choice, that whether he leaves his entire monthly salary in his account or shifting funds back and forth between checking account and bond fund. What should be Mr. A's frequency of shifting the funds between the bond fund and checking account?
(Note: Bond fund pays interest but adds a service charge of Rs.20 for each withdrawal)

Question No: 52 (Marks: 5)

Briefly explain the reasons that why the government gets involved in the financial system.

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Which relationship is shown by the monetary policy reaction curve?

What will be the change in monetary policy reaction curve if the given factors change?

c. An increase in the Central Bank's Inflation Target
d. An increase in the Long-run real interest rate