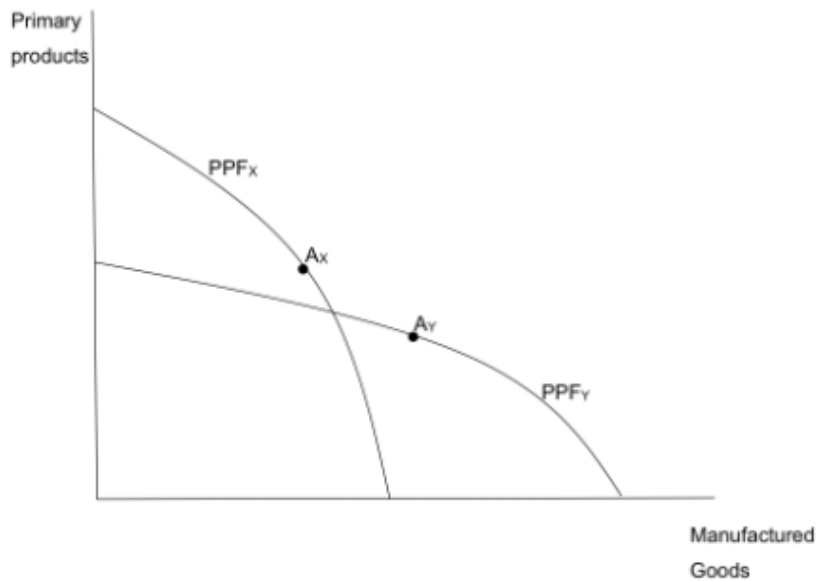


Consider the following diagram. PPF_X and PPF_Y denote the fixed production possibility frontier of countries X and Y and points A_X and A_Y denote production before trade.



Suppose the two countries decide to trade with each other and produce following principles of comparative advantage. Which of the following statements is true:

- a) Country X will consume more manufactured goods and less primary products.
- b) Country X will produce more manufactured goods and less primary products.
- c) Country X will consume more primary products goods and less manufactured goods.
- d) Country X will produce more primary products and less manufactured goods.

b)

Suppose two countries decide to trade with each other, they tend to arrive at the equilibrium of the system which is the intersection point of the two PPF curves. Therefore, after trade, X will produce more manufactured goods, and less primary goods.

A purchase of shares in a European company by a UK Citizen will appear on the UK

Balance of Payments as:

- a) A positive on the current account.
- b) A negative on the current account.
- c) A positive on the capital account.
- d) A negative on the capital account.

c)

Capital transferred out of a country for the purpose of investing in a foreign country is recorded as a debit in capital accounts, and a debit balance is an account balance where there is a positive balance in the left side of the account.

Consider an economy characterised by the quantity equation: $MV = PY$ where M is the total money supply and V is the constant velocity of circulation. Y is real output and P is the GDP deflator. Suppose a shock occurs that causes both cash demand and the reserve/deposits ratio to both increase. If the monetary authority keeps total reserves constant then:

- a) There will be deflation and output will be unaffected.
- b) The economy will shrink in real terms and prices will be unaffected.
- c) There will be both deflation and a contraction of the real economy.
- d) Any of the above are possible.

d)

When keeping total reserve constant, Reserve ratio increases -> lower money supply. Higher demand for money will decrease spending / investments, which decreases the velocity of money. Therefore $PY = MV$ is lower.

Suppose a Phillips curve of the form $\pi_t = \pi_t^e + 0.1 - U_t$ where π_t is the inflation rate and U_t is the unemployment rate (both at time t). Assume that inflation expectations (π_t^e) are formed 'adaptively', so that expectations of inflation in period t are equal to whatever the inflation rate was in the previous period, i.e. $\pi_t^e = \pi_{t-1}$. Which of the following statements is correct:

- a) There is a stable long run relationship between the change in the inflation rate and the unemployment rate.
- b) Inflation will equal 0.1.
- c) The slope of the Phillips curve is equal to 0.1.
- d) The Phillips curve will become unstable.

d)

When $\pi_t^e = \pi_{t-1}$

Then the Phillips curve has a unit root problem since the coefficient for π_{t-1} (against π_t) is now 1. Hence the Phillips curve will become unstable.

Question 7

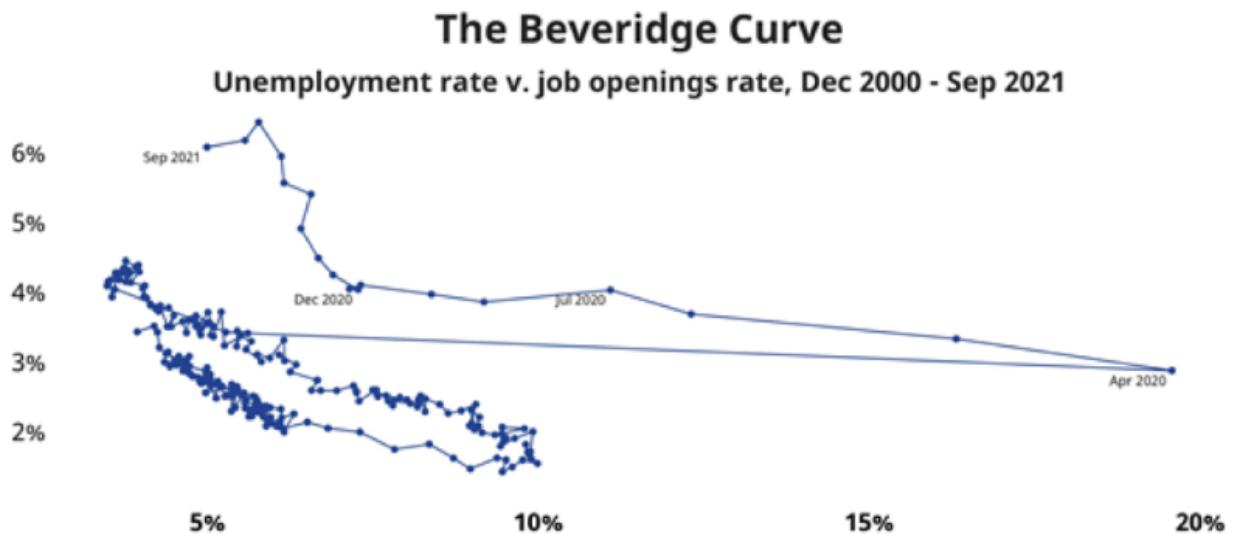
Consider the Solow model of economic growth where the economy is initially at its steady state. Suppose an increase in the savings rate. Which of the following statements is necessarily true:

- a) Consumption per capita will increase at the new steady state.
- b) Consumption per capita will decrease at the new steady state.
- c) The capital/output ratio will rise.
- d) The capital/output ratio will fall.

b)

Higher interest rates can lead to lower overall consumption. And the growth rates for capital and output are the same, so that the capital-output ratio is constant along a constant growth.

Consider the following diagram of the US Beveridge Curve with monthly observations from the past 20 years including some recent data through the COVID pandemic.



Source: Bureau of Labor Statistics

Based on this information we can conclude:

- a) The pandemic has increased long-run unemployment.
- b) The pandemic has reduced vacancy creation.
- c) The Beveridge curve is stable over time.
- d) None of the above.

d)

The horizontal axis shows the unemployment rate and the vertical axis shows the job vacancy rate (# of job vacancies / labor force). Therefore, based on the chart, from starting point to the end point, the unemployment rate is lower and job vacancy is higher. The curve fluctuated significantly between Dec 2020 and Sep 2021.