Open Economy Macroeconomics

Standard difficulty · 20 questions · 40 marks · Time: 37 minutes

Name: _____ Date: _____ Score: ____ / 40

Write full answers in Sections B and C. Answers are on the last page — try every question first!

Section A — Choose the correct answer — 8 × 1 = 8 marks

1. A record of a country's transactions with the rest of the world in a year is its:

(a) national income **(b)** balance sheet
(c) budget **(d)** balance of payments

2. Which of these is recorded in the capital account of India's balance of payments?

(a) repayment of a loan taken from abroad **(b)** spending by foreign tourists in India
(c) import of machinery **(d)** interest earned on deposits abroad

3. What is meant by "invisibles"?

(a) a market fall in the currency's value
(b) a flexible rate with central bank intervention
(c) record of a country's transactions with the world
(d) services, incomes and transfers

4. Suppose a country's exports of goods are ₹7,700 crore and imports of goods ₹2,100 crore. Its balance of trade is:

(a) a surplus of ₹5,600 crore **(b)** a deficit of ₹5,600 crore
(c) a surplus of ₹9,800 crore **(d)** a deficit of ₹9,800 crore

5. Suppose a country's balance of trade is −₹340 crore and its net invisibles are ₹300 crore. Its current account shows:

(a) a deficit of ₹40 crore **(b)** a surplus of ₹640 crore
(c) a surplus of ₹40 crore **(d)** a deficit of ₹640 crore

6. Suppose the exchange rate moves from ₹64 to ₹80 per dollar. By what percentage has the rupee price of a dollar risen?

(a) 26% **(b)** 50% **(c)** 12.5% **(d)** 25%

7. A machine costs $240 abroad. At ₹85 per dollar, what does an Indian buyer pay for it in rupees (ignoring transport and duties)?

(a) ₹20,400 **(b)** ₹204,000 **(c)** ₹325 **(d)** ₹20,640

8. By purchasing power parity, if a shirt costs ₹480 in India and $6 in the US, what should the long-run exchange rate be?

(a) ₹75 per dollar **(b)** ₹90 per dollar
(c) ₹80 per dollar **(d)** ₹480 per dollar

Section B — Short answer — 8 × 2 = 16 marks

9. What is an open economy?

10. Current account or capital account? (a) import of machinery (b) foreigners buying shares of Indian companies

11. Explain each term: (a) depreciation (b) current account

12. Suppose a country's BoP (₹ crore) has trade balance −90, net invisibles 420, capital account balance 500 and errors and omissions 0. Find the current account balance and the overall balance. What happens to official reserves?

13. The exchange rate moves from ₹47 to ₹42.3 per dollar under a flexible system. Has the rupee appreciated or depreciated? By what percentage did the rupee price of a dollar change?

14. A shirt costs $20 in the US and ₹1,600 in India. (a) What exchange rate does PPP give? (b) If prices rise by 50% in India and 20% in the US, what does PPP give now?

15. A student must pay fees of $35,000 abroad. How much is that in rupees at ₹68 per dollar, and how much more if the rupee depreciates to ₹75?

16. Under a flexible exchange rate, what happens to the rupee if (a) exports of Indian goods rise (b) Indians buy more foreign assets? Give a reason.

Section C — Longer answers — 4 × 4 = 16 marks

17. Explain the components of the current account.

18. Match each with its meaning: (a) managed floating (b) balance of payments (c) accommodating transactions. Choose from: transactions made to cover a BoP gap; a flexible rate with central bank intervention; record of a country's transactions with the world.

19. Suppose a country (₹ crore) exports goods worth 1,010 and imports goods worth 690; net invisibles are 120 and the capital account balance is 300. (a) Find the balance of trade. (b) Find the current account balance. (c) Find the overall BoP and say what the central bank must do with its reserves.

20. The exchange rate is ₹72 per dollar. (a) What is the rupee price of a $1,500 import? (b) The rupee depreciates so the dollar costs 25% more: find the new rate and the new rupee price. (c) How does this affect Indian exports?

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Answer key

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Q	Answer	Working
1	**(d) balance of payments**	—
2	**(a) repayment of a loan taken from abroad**	—
3	**(d) services, incomes and transfers**	—
4	**(a) a surplus of ₹5,600 crore**	7,700 − 2,100
5	**(a) a deficit of ₹40 crore**	−340 + 300
6	**(d) 25%**	(80 − 64) ÷ 64 × 100
7	**(a) ₹20,400**	240 × 85
8	**(c) ₹80 per dollar**	480 ÷ 6
9	**One that trades goods and services and has financial links with other countries.**	—
10	**(a) current (b) capital**	—
11	**(a) a market fall in the currency's value (b) trade in goods, services, incomes and transfers**	—
12	**current account ₹330 crore; overall a surplus of ₹830 crore; reserves rise by ₹830 crore**	−90 + 420; then + 500 + 0
13	**the rupee has appreciated; the dollar's price fell by 10%**	(47 − 42.3) ÷ 47 × 100
14	**(a) ₹80 per dollar (b) ₹100 per dollar**	1,600 ÷ 20; 2,400 ÷ 24
15	**₹2,380,000; ₹245,000 more**	35,000 × 68; 35,000 × (75 − 68)
16	**(a) the rupee appreciates (b) the rupee depreciates**	—
17	**Trade in goods (balance of trade) and invisibles: services, income such as interest and profits, and transfers such as gifts and remittances.**	—
18	**(a) a flexible rate with central bank intervention (b) record of a country's transactions with the world (c) transactions made to cover a BoP gap**	—
19	**(a) ₹320 crore (b) ₹440 crore (c) a surplus of ₹740 crore; reserves rise by ₹740 crore**	1,010 − 690; then + 120; then + 300

Q	Answer	Working
20	**(a) ₹108,000 (b) ₹90 per dollar; ₹135,000 (c) Indian goods become cheaper for foreigners, so exports tend to rise.**	1,500 × 72; 72 × 1.25