

# Contents



	PAGE
<i>Preface</i>	<i>I-5</i>
<i>Syllabus</i>	<i>I-7</i>
<i>Chapter-heads</i>	<i>I-9</i>

## CHAPTER 1

### **INTRODUCTION TO MACRO ECONOMICS**

<b>1.1</b>	What is Macroeconomics?	<b>1</b>
<b>1.2</b>	Significance of Macroeconomics	<b>2</b>
<b>1.3</b>	Macroeconomic Issues	<b>2</b>
<b>1.3.1</b>	GDP growth and Business Cycles	<b>2</b>
<b>1.3.2</b>	Unemployment	<b>5</b>
<b>1.3.3</b>	Inflation	<b>6</b>
<b>1.3.4</b>	International linkages	<b>7</b>
<b>1.3.5</b>	Macroeconomic policy	<b>7</b>
<b>1.4</b>	Positive and Normative approach	<b>7</b>
<b>1.5</b>	Schools of thought	<b>7</b>
<b>1.5.1</b>	Classical Economics	<b>8</b>
<b>1.5.2</b>	Normative approach of Classical	<b>9</b>
<b>1.5.3</b>	Keynesian Economics	<b>9</b>
<b>1.5.4</b>	Reunification of Classical and Keynesian Economics	<b>9</b>
<b>1.6</b>	Role of Macroeconomists	<b>10</b>
<b>1.6.1</b>	Macroeconomic Forecasting	<b>10</b>
<b>1.6.2</b>	Macroeconomic Analysis	<b>10</b>
<b>1.6.3</b>	Macroeconomic Research	<b>10</b>
<b>1.6.4</b>	Data Development	<b>10</b>
<b>SUMMARY</b>		<b>10</b>
<b>QUESTIONS</b>		<b>10</b>
<b>GLOSSARY</b>		<b>11</b>

## CHAPTER 2

### **NATIONAL INCOME ACCOUNTING**

<b>2.1</b>	National Income Accounting	<b>12</b>
<b>2.2</b>	Concept and Variants of GDP	<b>13</b>
<b>2.2.1</b>	Gross Domestic Product at market price ( $GDP_{MP}$ ):	<b>14</b>
<b>2.2.2</b>	Gross Domestic Product at factor cost ( $GDP_{FC}$ ):	<b>14</b>

	PAGE
2.2.3 Net Domestic Product at factor cost ( $NDP_{fc}$ ):	14
2.2.4 Net Domestic Product at Market Price ( $NDP_{mp}$ ):	14
2.2.5 Gross National Product at Market Price ( $GNP_{mp}$ )	14
2.2.6 Gross National Product at Factor Cost ( $GNP_{fc}$ )	15
2.2.7 Net National Product at Factor Cost ( $NNP_{fc}$ )	15
2.2.8 Net National Product at Market Price ( $NNP_{mp}$ ):	15
2.3 Three Methods of Calculating the National Income	17
2.3.1 Expenditure Method	17
2.3.2 Value Added Method/Product Method /Output Method	20
2.3.3 Income Method	21
2.4 Methods of GDP Accounting	22
2.5 Government and Private Sector's Savings	24
2.5.1 Private Income	24
2.5.2 Private Disposable Income	24
2.5.3 Government and Private Savings	25
2.5.4 Wealth and Savings	26
2.6 Real vs. Nominal	26
2.7 Price Index	27
2.8 GDP deflator	29
SUMMARY	30
EXERCISES	31
NUMERICALS	32
GLOSSARY	33

### CHAPTER 3

#### CLASSICAL SYSTEM OF DETERMINATION OF OUTPUT AND INTEREST RATE

3.1 Factors' Market	36
3.1.1 Factors of Production	36
3.1.2 Demand for labour	37
3.1.3 How production is distributed?	38
3.1.4 Cobb Douglas production function: A special case	39
3.2 Goods market equilibrium	39
3.3. Loanable funds theory	40
3.3.1 Investment and rate of interest	40
3.3.2 Government Borrowings	42
3.3.3 Savings and rate of interest	42
3.3.4 Equilibrium interest rate	43
3.3.5 Fall in expected profitability	44
3.4 Fiscal Policy	44
3.4.1 Effect of government spending on rate of interest	44

	PAGE
3.4.2 Effects of government spending on level of income	45
3.4.3 Tax Policy	46
3.5 Monetary policy	48
SUMMARY	48
QUESTIONS	48
GLOSSARY	48

## CHAPTER 4

### NATIONAL INCOME DETERMINATION

4.1 Two-Sector model	50
4.1.1 Consumption	50
4.1.2 Savings function	51
4.1.3 Investment	53
4.1.4 Equilibrium in two sector Model	54
4.1.5 The concept of multiplier	56
4.2 Three Sector Model	59
4.2.1 Equilibrium in a three sector model	59
4.2.2 Budget	61
4.2.3 Government purchase and its effects on budget surplus	62
4.2.4 Full Employment Budget Surplus	63
4.2.5 Impact of Change in tax structure on economy	64
4.2.6 Balanced budget multiplier	64
4.2.7 Automatic Stabilizers	64
4.3 Four Sector Model	66
4.3.1 Balance of Payments	66
4.3.2 Exports and Imports	66
4.3.3 Income Determination in 4 – Sector model	68
4.4 Changes in Equilibrium level of income	69
SUMMARY	73
QUESTIONS	73
NUMERICALS	73
GLOSSARY	74

## CHAPTER 5

### MONEY

5.1 Barter system	75
5.2 What is money?	76
5.3 The origins of money	76
5.3.1 Metallic money	76
5.3.2 Paper money	77
5.3.3 Fiat money	78
5.4 Functions of money	79

	PAGE
5.4.1 Medium of Exchange	79
5.4.2 Unit of Account	79
5.4.3 Store of Value	80
5.4.4 Standard of Deferred payments	80
5.5 Quantity theory of money	80
5.5.1 Transactions and the Quantity Equation	80
5.5.2 From transactions to Income	81
5.5.3 The Money Demand Function and the Quantity Equation(Cash Balance approach)	81
5.5.4 The assumption of constant velocity	83
5.5.5 Money, prices and inflation	83
SUMMARY	83
EXERCISES	84
NUMERICALS	84
GLOSSARY	84

## CHAPTER 6

### DEMAND FOR MONEY

6.1 Motives for holding money ( Demand for Money)	85
6.1.1 The transactions motive	85
6.1.2 Precautionary Motive	87
6.1.3 Speculative Motive	88
6.2 The money demand function	89
6.2.1 Money demand curve under Liquidity trap	91
6.2.2 Shifts in money demand function	92
6.3 Other factors affecting money demand	92
SUMMARY	93
NUMERICALS	93
GLOSSARY	94

## CHAPTER 7

### CREDIT CREATION AND MONETARY POLICY

7.1 Central Bank in India	95
7.1.1 Behaviour of RBI in macro economy	96
7.1.2 High-powered money and money supply	96
7.2 Credit creation	97
7.2.1 Types of Deposits	97
7.2.2 Balance sheet of Commercial Banks	98
7.2.3 Reserves	98
7.2.4 Ratios approach to credit creation process	99
7.2.5 Cash drain in process of credit creation	100

	PAGE
7.2.6 Money multiplier	100
7.2.7 H-theory of money: An alternative	102
7.3 Monetary Policy	103
7.4 Monetary policy tools	104
7.4.1 Open market operations	104
7.4.2 Required reserve ratio	105
7.4.3 Bank Rate	105
7.4.4 Repo and Reverse Repo rate	106
SUMMARY	106
EXERCISES	106
NUMERICALS	107
GLOSSARY	107

## CHAPTER 8

### INFLATION AND ITS SOCIAL COSTS

8.1 Inflation	108
8.2 Costs of inflation	110
8.2.1 The costs of expected inflation	110
8.2.2 The costs of unexpected inflation	111
8.3 Hyperinflation	112
8.3.1 The causes of hyperinflation	112
8.3.2 The costs of hyperinflation	112
8.4 Seigniorage and Inflation	113
8.5 Inflation in India	114
8.5.1 Price indices in India	114
8.5.2 Different phases	115
8.5.3 Movements in price indices	115
SUMMARY	116
EXERCISES	117
NUMERICALS	117
GLOSSARY	117

## CHAPTER 9

### IS LM MODEL

9.1 Goods market equilibrium	119
9.1.1 Investment demand function	120
9.1.2 Investment function, AE and IS curve	121
9.1.3 Slope of the IS curve	124
9.1.4 What shifts IS curve?	126
9.1.5 Points off the IS curve	127
9.1.6 Loanable funds theory and IS curve	128

	PAGE
<b>9.2</b> Assets market equilibrium	129
<b>9.2.1</b> Derivation of LM curve	130
<b>9.2.2</b> Shifts in LM curve	133
<b>9.2.3</b> Points off the LM curve	134
<b>9.3</b> General equilibrium in IS-lm model	135
<b>9.3.1</b> Simultaneous Equilibrium in goods and money market	135
<b>9.3.2</b> Disequilibrium in either markets	137
<b>9.3.3</b> Adjustment towards Equilibrium	138
<b>9.3.4</b> Money Market adjusts faster	138
<b>9.4</b> Multipliers and crowding out effect	139
<b>9.4.1</b> Monetary Policy and Transmission Mechanism	139
<b>9.4.2</b> Fiscal Policy	141
<b>9.4.3</b> Crowding out	143
<b>9.4.4</b> Monetary Policy Multiplier	143
<b>9.5</b> Crowding out	143
<b>9.5.1</b> Effectiveness of Policies	143
<b>9.5.2</b> Classical, Keynesian and Intermediate Range	145
<b>9.5.3</b> Other Cases of Crowding Out	149
<b>9.6</b> Composition of output and policy mix	150
<b>SUMMARY</b>	152
<b>QUESTIONS</b>	153
<b>GLOSSARY</b>	153

## CHAPTER 10

### AGGREGATE DEMAND AND AGGREGATE SUPPLY

<b>10.1</b> Aggregate Demand	154
<b>10.1.1</b> Why AD slopes Downward?	155
<b>10.1.2</b> Shifts in the aggregate demand	155
<b>10.2</b> Aggregate Supply	156
<b>10.2.1</b> Long run Supply curve	157
<b>10.2.2</b> Short run Aggregate Supply curve	158
<b>10.2.3</b> Transition from short run to long run	159
<b>10.3</b> Stabilization Policies	160
<b>10.3.1</b> Aggregate demand shocks	160
<b>10.3.2</b> Aggregate supply shocks	161
<b>10.3.3</b> Government Policies in advent of Shocks	161
<b>SUMMARY</b>	163
<b>EXERCISES</b>	163
<b>GLOSSARY</b>	163
<b>QUESTION PAPER 2017</b>	165
<b>QUESTION PAPER 2016</b>	168