MINIMUM LEVEL OF LEARNING - MACROECONOMICS

1. Distinguish between Stock & Flow.

STOCK	FLOW
* It refers to that variable which is measured at a point of time.	* It refers to that variable which is measured over a period of time.
It does not have time dimension.	* It has a time dimension as its magnitude can be measured over a period of time
* It is a static concept.	* It is a dynamic concept.
* Examples – Population of India as on 31.3.2014, Money Supply, National Wealth	* Examples – No of birth during 2014, national income, Expenditure in money.

2. Differentiate between consumption goods and capital goods.

CONSUMPTION GOODS	CAPITAL GOODS
* These goods satisfy human wants directly.	* Such goods satisfy human wants indirectly.
* These goods have direct demand.	* Such goods have derived demand.
They do not promote production capacity.	* They help in rising production capacity.
* Most of the consumption goods (except durable goods) have limited expected life.	* Capital goods generally have an expected life more than one year.

3. Write the steps while calculating National Income by Value Added Method?

STEPS-

(1) Identify and classify the production units. (2) Estimate Gross Domestic product at Market Price $\Sigma GVA_{MP} = GDP_{MP}$. (3) Calculate Domestic Income (NDP_{FC}) = $NDP_{FC} = GDP_{MP}$ – Depreciation – Net Indirect Tax. (4) Estimate net factor income from abroad (NFIY) to arrive at National Income. $NNP_{FC} = NDP_{FC}$ + NFIA. **OR**

Write the steps while calculating National Income by Income Method?

STEPS-

(1) Identify and classify the production units. (2) Estimate the factor income paid by each sector. (3) Calculate Domestic Income (NDP_{FC}) = NDP_{FC} = C.O.E. + Rent and Royalty + Interest + Profit + Mixed Income (4) Estimate net factor income from abroad (NFIY) to arrive at National Income. $NNP_{FC} = NDP_{FC}$ + NFIA. **OR**

Write the steps while calculating National Income by Expenditure Method?

STEPS-

(1) Identify the Economic units incurring Final Expenditure (2) Classification of Final Expenditure (PFCE + GFCE + GDCF + Net Export = GDP_{MP}) (3) Calculate Domestic Income (NDP_{FC}) = $NDP_{FC} = GDP_{MP}$ – Depreciation – Net Indirect Tax. (4) Estimate net factor income from abroad (NFIY) to arrive at National Income. $NNP_{FC} = NDP_{FC}$ + NFIA.

4. What precautions should be taken while calculating National Income by Value Added Method?

PRECAUTIONS-

(1) Intermediate Goods are not to be included in N.I. (2) Sale and Purchase of second hand goods is not included. (3) Production of services for self consumption (Domestic Services) is not included. (4) Production of Goods for self consumption is not included. (5) Imputed value of owner occupied houses should be included. (6) Change in stock of Goods (inventory) will be included. **OR**

What precautions should be taken while calculating National Income by Income Method?

PRECAUTIONS-

(1) Transfer Incomes are not included in the N.I. (2) Income from sale of second hand goods will not be included. (3) Income from sale of shares, bonds and debentures will not be included. (4) Windfall gains. (5) Imputed value of services provided by owners of production units will be included. (6) Payments out of past savings are not included in the N.I. (7) Indirect Taxes are not included in N.I. at factor cost. **OR**

What precautions should be taken while calculating National Income by Expenditure Method?

PRECAUTIONS-

(1) Expenditure on Intermediate Goods will not be included in the National Income. (2)Transfer payments are not included. (3) Purchase of second hand goods will not be included. (4) Purchase of financial assets (shares, debentures, Bonds) will not be included. (5) Expenditure on own account production will be included in the National Income.

5. **Explain the credit creation by commercial bank with a numerical example.**

MONEY CREATION OR CREDIT CREATION - Money creation (or deposit creation or credit creation) by the commercial banks is determined by (1) The amount of the **initial fresh deposit** and (2) The **Legal Reserve Ratio (LRR) –** It is the minimum ratio of deposit legally required to be kept as cash by the banks. LRR includes **Cash Reserve Ratio –** It is the minimum proportion of cash reserves which is kept by commercial banks with the central bank against its total deposits; and **Statutory Liquidity Ratio –** It is that proportion of the total deposits which a commercial bank has to keep with itself in the form of liquid assets (i.e. cash, gold and unencumbered approved securities). It is assumed that all the money that goes out of banks is redeposit into the banks.

PROCESS - Let the LRR be 20% and there is a fresh deposit of Rs.10000. As required the banks keep 20% i.e. Rs 2000 as cash. Suppose the banks lend the remaining Rs8000 those who borrow use this case money for making payments as assumed those who receive payments put the money back into the banks in this way banks receive fresh deposits of Rs 8000. The banks again keeps 20% i.e. Rs1600 as cash and lend Rs.6400 which is also 80% of the last deposit the money again comes back to the banks' lending to a fresh deposit of Rs 6400. The money goes on multiplying in this way and ultimately total money creation is Rs =50000. Credit creation by banks is done by the formula.

As seen in the table, banks are able to create total deposits of Rs. 50000 with the initial deposits of just Rs. 10000. It means, total deposits become 'five times' of the initial deposit. Five times means Value of 'Money Multiplier'.

Money Multiplier or Deposit Multiplier – It measures the amount of money that the banks are able to create in the form of deposits with every unit if money it keeps as reserves.

<table>
<tr><th>Initials Deposits</th><th>Deposits</th><th>Loans</th><th>LRR=20%</th><td rowspan="8">Money Creation = Initial Deposit x 1/LRR,
Money Multiplier = 1/LRR
Money Creation = Initial Deposit x Money Multiplier
Money Multiplier = 1/ (20/100), 1/0.20 = 5
Money Creation = Initial Deposit x Money Multiplier
Money Creation = 10000 x 5 = 50000</td></tr>
<tr><td>Round - 1</td><td>10000</td><td>8000</td><td>2000</td></tr>
<tr><td>Round - 2</td><td>8000</td><td>6400</td><td>1600</td></tr>
<tr><td>Round -3</td><td>6400</td><td>5120</td><td>1280</td></tr>
<tr><td></td><td>---</td><td>---</td><td>---</td></tr>
<tr><td></td><td>---</td><td>---</td><td></td></tr>
<tr><td>Total</td><td>50000</td><td>40000</td><td>10000</td></tr>
</table>

6. **Explain the functions of Central Bank.**

1. Currency Authority or Bank of Note Issue - Central bank is a sole authority to issue currency in the country. The main advantages of sole authority of note issue. (a)Uniformity in note circulation, (b) Better supervision and control, (c) It is easy to control credit, (d) Ensure public faith, (e) Stabilization in internal and external value of currency.

2. Banker's Bank-

RBI acts as Bankers bank in 3 capacities-

Banker's Bank and Supervisor – There are no of commercial bank in country. There should be some agency top regulate and supervise their proper functioning. Being the apex bank, The RBI regulates and controls the commercial banks. The regulation of banks may be related to their licensing, branch expansion, liquidity of assets, management, Merging, winding up etc. The control is exercised by periodic inspections of banks and the returns filed by them.

Custodian of Cash Reserve – Commercial Banks must keep a certain proportion of cash reserves with the central banks from their total Deposit (known as Cash Reserve Ratio or CRR).

Lender of Last Resort - The central bank also acts as lender of last resort for the other banks of the country. It means that if a commercial bank fails to get financial accommodation from anywhere, it approaches the central bank as a last resort. Central bank advances loan to such a bank against approved securities. As a lender of the last resort, central bank exercises control over the entire banking system of the country.

<u>3. Banker to the Government –</u> The central bank act as a banker, an agent and a financial advisor to the central government and all the state governments except J&K).

<u>Banker to the Government –</u> As a Banker - to the govt., it acts like commercial bank to the public. Accepts receipts & makes payment for the govt. It provides short term credit to the govt. It provides foreign exchange resources to the govt. to repay external debt. It manages public debt. It advises the govt. on banking & financial matters.

<u>As an Agent –</u> The central bank also has the responsibility of managing the public debt and collect taxes.

<u>As a financial Advisor –</u> The central bank advises the government from time to time on economic, financial and monetary matters.

<u>4. Clearing House -</u> Every bank keeps cash reserves with the central bank. The claims of banks against one another can be easily and conveniently settled by simple transfers from in to their account. Supposing, Bank A receives a cheque of Rs 10,000 drawn on Bank B and Bank B receives a cheque of Rs. 15000 drawn on Bank A. The most convenient method of settling or clearing their mutual claims is that Bank A should issue a cheque amounting to Rs 5000 in favour of Bank B, drawn on central Bank. As a result of this transference, a sum of Rs 5000 will be debited to the account of Bank A and credited to the account of B. There is no need of cash transactions between the banks concerned. It facilitates cash transaction across the entire banking system, it also reduces requirement of cash reserves of the commercial banks.

<u>5. Custodian of Foreign Exchange Reserves -</u> Another important function of Central Bank is the custodian of foreign exchange reserves. Central Bank acts as custodian of country's stock of gold and foreign exchange reserves. It helps in stabilizing the external value of money and maintaining favorable balance of payments in the economy.

<u>6. Controller of Money Supply and Credit –</u> Central bank or RBI plays an important role during the times of economic fluctuations. It influences the money supply Through Quantitative instruments (like – Bank Rate, Open Market Operations, legal Reserve ratios, Cash reserve Ratios, Statutory Liquidity ratios) and Qualitative instruments (like – Moral Suasion, Credit Rationing, Direct Action, Margin Requirements).

7. What do you mean by double coincidence of wants? OR

What are the drawbacks of barter system? How money overcome to this problem?

<u>Draw Backs of Barter System –</u>

1. Problem of Double Co incidence of Wants – A can exchange goods with B only when A has what B wants and B has what A wants.
2. Lack of Common Measure of Value
3. Lack of Standard of Deferred Payment
4. Difficulty in Storing Wealth.
5. Lack of Divisibility.

8. Explain the Income determination by AD = AS approach. How to reach at Equilibrium when AD>AS & AS>AD?

<u>AD = AS Approach –</u> Equilibrium level is determined when AD is equal to AS.

<u>AD>AS =</u> It means that consumers and firms together would be buying more goods than the firms are willing to produce. As a result planned inventory would fall below the desired level. To bring the inventory back to the desired level, firms would resort to increase in employment and output till the economy is back at output level at OY, where AD is become to AS and there is no further tendency to change.

<u>AS>AD =</u> It means that consumers and firms together would be buying less goods than the firms are willing to produce. As a result planned inventory would rise. To clear the unwanted increase in inventory, firms Plan to decrease the employment and output till the economy is back at output level at OY, where AD is become to AS and there is no further tendency to change.

9. Explain the Income determination by I=S approach. How to reach at equilibrium when I > & I<S?

<u>I = S Approach –</u> Equilibrium level is determined when I = S.

I > S = If planned saving is less than planned investment, i.e. before point E. It means that households are consuming more and saving less than what the firms expected them to. As a result planned inventory would fall below the desired level. To bring the inventory back to the desired level, firms would plan to increase in employment and output till saving and investment equal to each other and there is no further tendency to change.

S > I = If planned investment is less than planned saving, i.e. after point E. It means that households are not consuming as much as the firms expected them to. As a result inventory rises above the desired level. To clear the unwanted increase in inventory, firms would plan to reduce the production till saving and investment equal to each other and there is no further tendency to change.

10. How will you derive the saving curve from consumption curve? OR
How will you derive the consumption curve from saving curve?

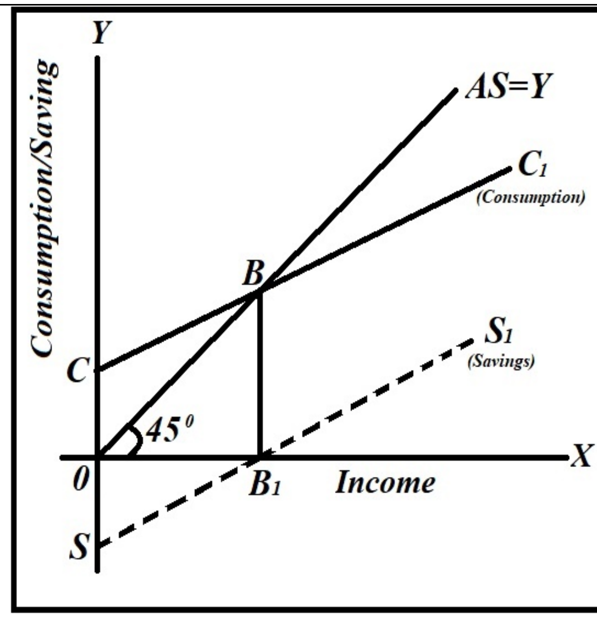
saving curve from consumption curve

We can derive saving curve from the given consumption curve by taking following steps –

1. Take a point B on consumption curve and from it draw a perpendicular on x axis intersecting it at point B1.
2. Take OS on y axis of lower part as equal to OC (as OC=OS as Autonomous Consumption is equal to dissaving). This gives point S from where saving curve will start.
3. Join pint S and B1 and extend the straight line upward and thus we get saving curve SB1S1.

In this way saving curve is diagrammatically drawn from consumption curve.

APC at point B is = 1, because consumption is equal to income and savings = 0.



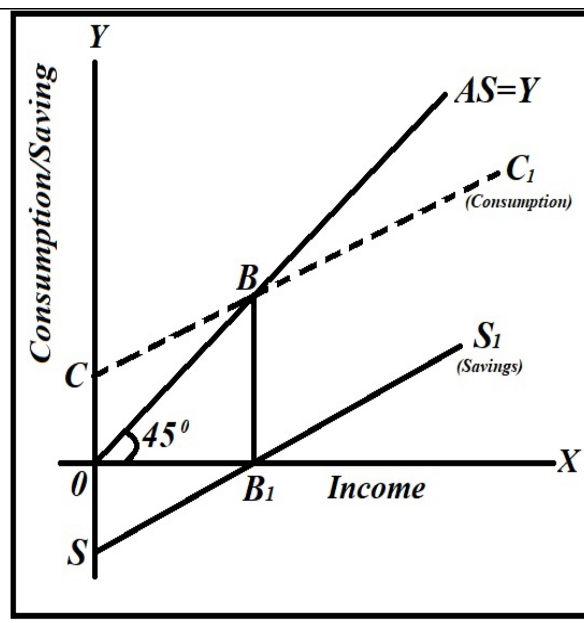
consumption curve from saving curve

We can derive consumption curve from the given saving curve by taking following steps –

1. Take a point B1 on Saving curve and from it draw a perpendicular on x axis parallel to Y axis intersecting Income curve at point B.
2. Take OC on y axis as equal to OS (as OS=OC as dissaving is equal to Autonomous Consumption). This gives point C from where consumption curve will start.
3. Join pint C and B and extend the straight line upward and thus we get consumption curve CBC1.

In this way consumption curve is diagrammatically drawn from saving curve.

APC at point B is = 1, because consumption is equal to income and Savings = 0.



11. Distinguish between Excess demand & Deficient demand. How will you correct the Excess demand ($AD_{required} < AD_{actual}$) (Inflationary Gap) situation with fiscal policy and monetary policy? OR

Distinguish between Excess demand & Deficient demand. How will you correct the Deficient demand ($AD_{required} > AD_{actual}$) (Deflationary Gap) situation with fiscal policy and monetary policy?

EXCESS DEMAND - It is a situation when actual aggregate demand is more than aggregate demand required at the full employment equilibrium. It is also known as Inflationary Gap.

DEFICIENT DEMAND - It is a situation when actual aggregate demand is less than aggregate demand required at the full employment equilibrium. It is also known as Deflationary Gap.

EXCESS DEMAND	**CORRECTION MEASURES**			**DEFICIENT DEMAND**
	FISCAL MEASURE (ADOPTED BY GOVERNMENT)			
It refers to the situation when AD >AS at full employment equilibrium.	Decrease	**Expenditure Policy**	Increase	It refers to the situation when AD<AS at full employment equilibrium.
	Increase	**Taxation Policy**	Decrease	
It leads to Inflationary gap.	Increase	**Public Borrowings**	NO	It leads to Deflationary Gap.
Its indicate Over Full Employment equilibrium.	NO	**Deficit Financing**	Yes	Its show Under Employment Equilibrium.
	MONETARY POLICY – QUANTITATIVE (ADOPTED BY RBI)			
It occurs due to excess of anticipated expenditure, i.e. due to rise in consumption expenditure, investment expenditure, etc.	Increase	**BANK RATE**	Decrease	It occurs due to shortage of anticipated expenditure, i.e. due to fall in consumption expenditure, investment expenditure, etc.
	Increase	**REPO RATE**	Decrease	
	Increase	**RVERSE RAPO RATE**	Decrease	
	Increase	**CASH RESERVE RATIO**	Decrease	
	Increase	**S. L. R.**	Decrease	
It does not affect the Output, Employment and Income level as economy is already operating at full employment level.	Sell of Securities	**OPEN MARKET OPERATION**	Purchase of Securities	It leads to fall in output and employment due to shortage of aggregate demand.
	MONETARY POLICY – QUALITATIVE (ADOPTED BY RBI)			
	Increase	**MARGIN REQUIRMENTS**	Decrease	
It leads to inflation, i.e. it results in rise in general price level.	Follow by Commercial banks	**MORAL SUASSION**	Follow by Commercial banks	Its leads to deflation, i.e. it results in fall in general price level.
EX ANTE SAVING – What households plan to save at different levels of Income in an economy. It is shown by saving function. **EX-ANTE INVESTMENT –** What firms plan to invest at different levels of income in an economy. It is shown by investment demand function.	Selected Credits	**CREDIT RATIONING**	Encourage Credits	**EX-POST SAVING –** It is the actual or realized savings in an economy during a year. **EX-POST INVESTMENT –** It refers to the actual or realized investment in an economy during a year. Ex-post saving and Ex-post Investment are equal at all levels of income.
	Stop functioning as banker's bank	**DIRECT ACTION**	Stop functioning as banker's bank	
	IMPACT ON VARIOUS SECTOR			
	EXCESS DEMAND		**DEFICIENT DEMAND**	
	No Change	**Employment**	Fall	
	No Change	**Output**	Fall	
	No Change	**National Income**	Fall	
	Rise	**General Price Level**	Fall	
	POSSIBILITIES OF EQUILIBRIUM AT EMPLOYMENT LEVEL			

FULL EMPLOYMENT EQUILIBRIUM	**UNDER EMPLOYMENT EQUILIBRIUM**	**OVER FULL EMPLOYMENT EQUILIBRIUM**

12. **What is Government budget? Explain the objectives of budget.**

Meaning of Government Budget:-A government budget is an annual statement of the estimated receipts and estimated expenditure during a fiscal year.

Objective of the Government Budget

The objective that are pursued by the government through the budget are-

1. To Achieve Economic Growth.
2. To Reduce Inequalities in Income and Wealth.
3. To Achieve Economic Stability.
4. To Management of Public Enterprises.
5. To Reallocation of Resources.
6. To Reduce regional Disparities.

13. **Explain the implications of:**

1. Revenue Deficit. 2. Primary Deficit. 3. Fiscal Deficit.

@ Revenue Deficit:-Revenue deficit refers to the excess of revenue expenditure of the government over its revenue receipts.

Revenue deficit = Total revenue expenditure – Total revenue receipts.

Importance:- Since it is largely related with the recurring expenditure. Therefore, high revenue deficit gives a warning to the government either to cut expenditure or to increase revenue receipts. It also implies requirement burden in future.

@ Fiscal Deficit:-Fiscal deficit is defined as excess of total expenditure over total receipts excluding borrowings.

Fiscal Deficit = Total budget expenditure - Total budget receipts (excluding borrowings)

Importance: - Fiscal deficit is a measure of total borrowings required by the government. Greater fiscal deficit implies greater borrowings by the government. This creates a large burden of interest payments in the future that leads to increase in revenue expenditure, causing an increase in revenue deficit. Thus a vicious circle sets in. In the present, a large fiscal deficit may also lead to inflationary pressures.

@ Primary Deficit: -Primary deficit is defined as fiscal deficit minus interest payment. It is equal to fiscal deficit reduced by interest payment.

Primary deficit = Fiscal deficit – interest payment.

Importance: - Primary deficit signifies borrowing requirements of the government. A low or zero primary deficit means that while government's interest requirement on earlier loans have compelled the government to borrow but it is aware of the need to tighten its belt.

14. **Differentiate between Revenue Budget & Capital Budget.**

BUDGET COMPONENT

BUDGET RECEIPT				BUDGET EXPENDITURE			
CAPITAL RECIEPT		REVENUE RECEIPT		CAPITAL EXPENDITURE		REVENUE EXPENDITURE	
Either Creates Liability	Or Reduce Assets	Neither Create Liability	Nor Reduce Assets	Either Creates Assets	Or Reduce Liability	Neither Create Assets	Nor Reduce Liability
* It's always creating a liability. * Capital Receipts causes for reduction in the assets of the government. * Eg. Borrowings, Disinvestment, Recovery of loans etc.		* Revenue Receipts do not create any liability. * It's does not reduce assets of the government. * Eg. Dividend, Tax and non tax revenue.		* It results in creation of assets. * It result in reduce in liability. * It for long period and non-recurring in nature. * Eg. Expenditure on acquisition of assets like land, building etc.		* It does not result in creation of assets. * It does not reduce any liability. * It is for day to day activity and recurring in nature. * Eg. Expenditure on salaries of employees.	
1. Borrowing 2. Disinvestment 3. Recovery of Loans 4. Small Savings- NSC, KVP		1. Tax and Non Tax Revenue 2. Interest Received on loans 3. Gift and Grants 4. Profit of PSUs		1. Construction Activities 2. Lending loans 3. Defense Capital Equipments 4. Repayment of Loan		1. Payment of Interest 2. Expenditure on General Services 3. Subsidies 4. Grants Given to State Govt.	

15. Differentiate between Direct and Indirect tax.

Direct Tax	Indirect Tax
* Liability to pay and burden of direct tax falls on same person.	* Liability to pay and burden of direct tax falls on some other person.
* Direct taxes are levied on individuals and companies.	* Indirect taxes are levied on goods and services.
* Levied on income and property of person.	* Levied on goods and services on their sale, Production, import and export.
* Direct taxes are generally progressive in nature.	* Indirect taxes are generally proportional in nature.
* Eg. Income tax, Corporate tax, Wealth Tax, Capital Gains etc.	* Eg. Sales tax, Service Tax, Excise duty, Custom duty etc.

16. What are the components of current account of Balance of Payment?

CURRENT ACCOUNT - The current account records all transactions related to imports and exports of goods and services and unilateral transfers during a given period of time. The main components of this account are -

(1) EXPORT AND IMPORT OF GOODS – (Visible Items) – The balance of export and import of goods is called the balance of visible trade. Payment for import of good is written on the negative side and receipt from export is shown on positive side.

(2) EXPORT AND IMPORT OF SERVICES (Invisible Trade) -The balance of exports and imports of services is called the balance invisible trade. Example - Shipping, Banking, Insurance etc. Payments for these services are written on the negative side and receipt on positive side.

(3) UNILATERAL TRANSER TO AND FRO ABROAD -Unilateral transfers is receipts which residents of a country make without getting anything in return eg. Gifts, donation, personal remittances etc.

(4) INCOME RECIEPT AND PAYMENT TO AND FRO ABROAD – It includes income in the form of interest, rent and profits.

The net balance of visible trade, invisible trade and of unilateral transfers is the balance on current account. Current Account shows the Net Income.

17. What are the components of capital account of Balance of Payment?

It records are international transactions that involve a resident of the domestic country **changing his assets or liability** with a foreign resident. It is concerned with financial transfers. So it does not have direct effect on income, output and employment of the country.

Various forms of capital account transactions:-

(1) PRIVATE TRANSACTIONS - There are transactions that affect the liabilities and assets of individuals.

(2) OFFICIAL TRANSACTIONS - Transactions affecting assets and liabilities by the govt. and its agencies.

(3) PORTFOLIO INVESTMENT (FII) - It is the acquisition of an asset that does not give the purchaser control over the asset.

(4) DIRECT INVESTMENT (FDI)- It is the act of purchasing an asset and at the same time acquiring control of it.

(5) BANKING INFLOW – Inflow of hot money seeking the highest rate of return as NRI deposits.

(6) OFFICIAL RESERVE TRANSACTION – It includes change in a countries gold reserves, foreign exchange reserves, foreign securities and SDRs with IMF.

The net value of the balance of direct and portfolio investment is called the balanced on Capital Account.

18. Differentiate between Balance of Trade and Balance of Payment. OR

Differentiate between Autonomous items & Accommodating items.

AUTONOMOUS ITEMS	ACCOMODATING ITEMS
Autonomous items refer to international economic transactions that take place due to some economic motive such as profit maximization.	This refers to transactions that occur because of other activity in the BOP, such as government financing.
These transactions are independent of the state of	These transactions are responsible for country's

the country's BOP.	BOP.
These items are often called above the line items in the BOP.	These items are called below the line items.
CURRENT ACCOUNT * It records all transaction between the resident of a country and the rest of the world which does not change asset and liability * It is a flow concept * It consist of export and import of goods, services and unilateral transfer	**CAPITAL ACCOUNT** * It records all transaction between the resident of a country and the rest of the world which change asset and liability * It is a stock concept * It consist of borrowing and lending, change in foreign exchange reserve and FDI
BALANCE OF TRADE	**BALANCE OF PAYMENTS**
Balance of trade is a record of only visible items i.e. exports and imports of goods.	Balance of payments is a record of both visible items (goods) and invisible items (services)
Balance of trade can be in a deficit, surplus or balanced	Balance of payments must always balance.
Unfavorable BoT can be met out with of favorable BoP.	Unfavorable BoP cannot be met out with of favorable BoT.
BOT does not record ant transaction of capital nature.	BOP records all the transactions of capital nature.
Balance of trade is a narrower concept as it is only a part of the balance of payments account.	Balance of payments is a wider and more useful concept as it is a record of all transactions in foreign exchange including balance of trade.

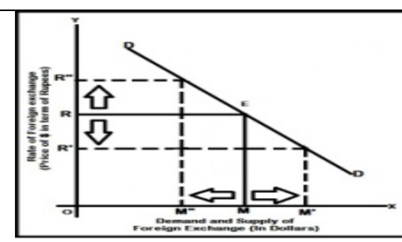
19. Why foreign exchange demanded?

20. What are the supply sources of foreign exchange

21. Explain foreign exchange rate determination.

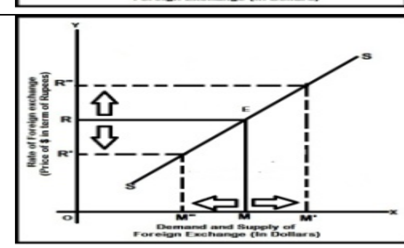
DEMAND OF FOREIGN CURRENCY

1. Import of goods and services from other countries;
2. Tourism;
3. Unilateral Transfers sent to abroad;
4. To purchase assets in foreign countries;
5. To speculate on the value of foreign currencies

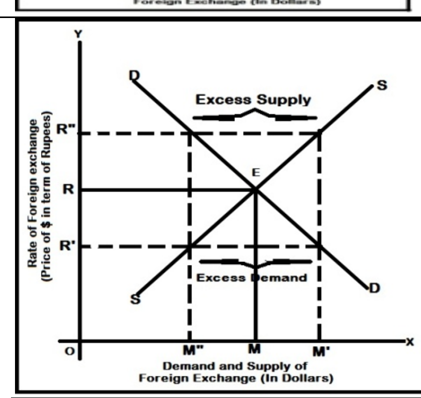


SUPPLY SOURCES OF FOREIGN

1. Export of Goods and Services to other countries;
2. Tourism;
3. Foreign investment like FDI and FII;
4. Unilateral Transfers received from abroad;
5. Speculation



DETERMINATION OF EXCHANGE RATE Equilibrium in the foreign exchange market is determined in the same way as the price of a commodity through the forces of supply and demand. The foreign exchange market, like any other normal market, contains a downward sloping demand curve and an upward sloping supply curve. The price on the vertical axis is stated in terms of domestic currency (i.e. how many rupees for one US dollar).The horizontal axis measures the quantity demanded or supplied. The intersection of the supply and demand curve determines the equilibrium foreign exchange rate



22. Impact of Appreciation / Revaluation and Depreciation / Devaluation on its export & Import of a country.

23. Differentiate between Appreciation & Depreciation.

24. Differentiate between revaluation & devaluation.

DEPRICIATION	**DEVALUATION**
Depreciation refers to fall in the price of domestic currency in terms of foreign currency.	It refers to reduction in the price of domestic currency by the government in terms of foreign currency.
It takes place due to market demand and market supply of foreign exchange.	It is done deliberately by the government or central bank
It takes place under Flexible Exchange Rate System	It takes place under Fixed Exchange Rate System.
It is very common.	It is very uncommon.
DEPRICIATION	**APPRICIATION**
Depreciation refers to fall in the price of domestic currency in terms of foreign currency.	Appreciation refers to rise in the price of domestic currency in terms of foreign currency.
IMPACT ON EXPORT AND IMPORT -It makes domestic goods cheaper in foreign country as more of such goods can now be purchased with same amount of foreign currency. So, it leads to increase in export and decrease in Import. (Same result will be in case of Devaluation)	**IMPACT ON EXPORT AND IMPORT -**It makes foreign goods cheaper in domestic country as more of such goods can now be purchased with same amount of domestic currency. So, it leads to increase in import and decrease in Export.(Same result will be in case of Revaluation)
A change from 1 $ = 50 Rs. to 1 $ = 55 Rs. is Depreciation of Indian Currency.	A change from 1 $ = 50 Rs. to 1 $ = 45 Rs. is Appreciation of Indian Currency.
FIXED EXCHANGE RATE	**FLEXIBLE EXCHANGE RATE**
It is officially fixed by the government in terms of gold or any other currency.	It is determined by the forces of demand and supply of foreign exchange.
Traditional exchange rate system (adopted by all countries from 1946 to 1973)	New exchange rate system (adopted by almost all countries after 1973)
The exchange rate is generally stable or a very small variation possible	The exchange rate keeps on changing.
In this system only government has the power to change exchange rate.	Market forces changes the exchange rate. (In Managed Floating RBI can intervene under certain limits)

25. Write short notes on fixed exchange rate, Flexible exchange rate & Managed floating exchange rate.

26. Merits & demerits of fixed exchange rate, Flexible exchange rate & managed floating exchange rate.

FIXED EXCHANGE RATE - Under the fixed exchange rate system the exchange rate is officially declared and it is fixed. Only a very small deviation from this fixed value is possible. It is not determined by supply of and demand for foreign exchange.

MERITS – 1. Stability in the exchange Rate; **2.** Promote International Investment; **3.** Promotes International Trade; **4.** Prevent Speculative Activity; **5.** Coordination of Macroeconomics Policies. **DEMERITS – 1.** Huge foreign Exchange Reserves Required; **2.** Difficulty in fixing the Exchange rate; **3.** Exchange Rates are not fixed.

FLEXIBLE EXCHANGE RATE - In the flexible exchange rate system exchange rate is determined by the supply and demand for foreign exchange. There is no intervention by the central bank

MERITS – 1. Maintains Equilibrium Level; **2.** No need or Huge Foreign Exchange Reserves; **3.** Optimum Utilization of resources **DEMERITS – 1.** Instability in the Exchange Rate; **2.** Speculative Activities; **3.** Creates Inflationary Situation

MANAGED FLOATING EXCHANGE RATE - In this system foreign exchange rate is determined by the market demand and supply and central bank can intervene in foreign exchange rate determination whenever it feels desirable. It is also known as dirty floating.