SEMESTER ONE JANUARY 2026

ABERYSTWYTH BUSINESS SCHOOL

AB33120: Contemporary issues in Economics and Policy

Time allowed: **3 HOURS**

Answer THREE questions

CALCULATORS ARE PERMITTED (Casio FX83, FX85 & FX99-1 models only)

MAE MODD I FYFYRWYR GYFLWYNO ATEBION I'R PAPUR HWN NAILL AI YN Y GYMRAEG NEU'R SAESNEG

STUDENTS MAY SUBMIT ANSWERS TO THIS PAPER IN EITHER WELSH OR ENGLISH OF THE MODULE

Once seated, students may complete the front cover of the answer book(s) and the attendance slip ONLY.

DO NOT TURN THE EXAMINATION QUESTION PAPER OVER UNTIL INSTRUCTED TO DO SO.

SECTION A

Question 1

In this question you are asked to set up a sequential game of entry, where a monopolist is faced with an entry of a rival firm. The monopolist threatens to retaliate and fight the entry. If no entry is chosen, then the game ends with 0 payoff for the entrant and a payoff of 50 for the monopolist. If the entrant chooses to enter, then the monopolist has the choice of retaliating or sharing the market with the entrant. Retaliation results in payoffs of -10 for the entrant and 10 for the monopolist. Sharing the marker results in payoffs of 10 for the entrant and 20 for the (no longer) monopolist.

a) Set up the extensive form (game tree) for this game and assign payoffs. Find a subgame perfect Nash equilibria for this game. Comment on the credibility of the threat to retaliate in response to entry.

[50%]

b) Suppose the monopolist makes a pre-commitment to retaliate in case of entry. The pre-commitment works as follows: If the monopolist does not retaliate in response to the entry and chooses to share the market, then the monopolist pays a penalty of 40 and its payoff becomes -20. Find the subgame perfect Nash Equilibrium with pre-commitment. Comment on the credibility of the threat to retaliate in response to entry with pre-commitment.

[50%]

Question 2

	Cooperate	Don't cooperate
Cooperate	3, 3	0, 1
Don't cooperate	1, 0	1, 1

Consider the game represented in the game matrix.

a) Derive the pure strategy Nash equilibrium. [20%]

b) If *c* is the share of cooperating in the population, derive the mixed strategy equilibrium [40%]

c) How can the mixed strategy equilibrium be interpreted from the point of view of socio-evolutionary game theory? Explain whether this equilibrium is evolutionary stable or unstable. [40%]

Question 3

Consider a football penalty game represented in the game matrix.

goalkeeper

striker	Left	Middle	Right
Left	0,3	4, 0	4,0
Middle	3,0	0, 3	3,0
Right	4,0	4,0	0,3

a) Derive a pure strategy Nash equilibrium. [40%]

b) Derive a mixed strategy equilibrium [40%]

c) Explain how one can employ the concept of mixed strategy equilibrium to help design policies and interventions. [20%]

SECTION B

Question 4

a) Explain the absolute and relative form of the PPP. [30%]

b) What might explain deviations from the PPP in the short run? [40%]

c) Explain the Uncovered Interest Parity. [30%]

Question 5

Discuss the effect of an unexpected permanent increase in money supply on the price level and the exchange rate according to i) the flexible price monetary model and ii) Dornbusch's overshooting model [100%]

Question 6

a) Explain what Quantitative Easing is and discuss the channels through which it affects inflation and output. [50%]

b) Discuss the potential risks of using Quantitative Easing over long periods [50%]

END OF PAPER