Semester 2 2026

ABERYSTWYTH BUSINESS SCHOOL

AB23220: MACROECONOMICS: THEORY AND POLICY APPLICATIONS

Time allowed: **3 HOURS**

Answer ANY THREE questions

CALCULATORS ARE PERMITTED (Casio FX83 or FX85 models only)

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

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.

Question 1:

a) Using the closed-economy IS/LM model, explain the effect of expansionary fiscal policy (increase in government spending) on the level of income and the interest rate (50 marks)

b) Discuss what the central bank should do to keep the interest rate at its initial level following the fiscal expansion (50 marks)

Question 2:

Consider a closed economy described by the following equations:

Consumption: $C = 100 + 0.5 * (Y - T)$

Investment: $I = 50 - 50 * r$

Government Spending: $G = 200$

Taxation: $T = 100$

Real money demand: $L = Y - 50 * r$

Nominal money supply: $M_s = 1500$

Price: $P = 5$

a. Derive and graph the IS and the LM curve. (25 marks)

b. Find the equilibrium real output (Y) and interest rate (r). (25 marks)

c. Suppose that the government aims to bring the economy back to the long-run equilibrium (Y=800) with the price fixed at 5. What is the level of government spending that is needed. (50 marks)

Question 3

Explain how monetary policy is transmitted in a small open economy under floating exchange rates. . (100 marks)

Question 4

a. Discuss why policy makers care about the level of inflation and have a target of low and stable inflation (40 marks)

b. Discuss how monetary policy is conducted by the Bank of England (60 marks)

Question 5

Using the AD/AS model, discuss the effect of a negative supply-side shock on a closed-economy's level of prices and income in the short and the long run. (100 marks)

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Question 6

a. Discuss the assumptions of the Solow growth model. (30 marks)

b. Discuss the steady-state equilibrium in the Solow growth model (assuming population growth but no technological progress). (30 marks)

c. Provide examples of government policies that can promote growth. (40 marks)

END OF PAPER