

Ans 1. A **free-floating exchange rate** is one where a currency's value is determined by demand and supply in the foreign exchange market, without the central bank fixing its value.

Its advantages are:

- ❖ Automatic adjustment Currency depreciation can make the exports easier and feasible where as the imports get costlier hence the trade deficit reduces.
- ❖ Monetary freedom: the Central bank can levy flexible interest rates
- ❖ Lower reserve requirement: The automatic adjustment facilitates and results in not being forced to maintain a large reserve to maintain the fixed currency exchange rate.

Its disadvantages:

- ❖ Volatility: the floating exchange rate is subject to demand and supply hence it makes the currency very volatile, eg: overnight price increase of oil commodity.
- ❖ Imported inflation : The inflated import prices effect procuring of raw materials at low price. **The direction of the points seems to be ccorrect, but it needs to be framed as per the question requirement, you must mention it as “due to uncertainty in the currency exchange rate and hence imports price, governments cannot make efficient strategies for the same”**
- ❖ Speculation : Any adverse or positive speculation can drop or boost the currency exchange rate.
- ❖ Foreign debt burden : Domestic currency paying costs are increased in case of repayment of foreign debt. Eg: previously country A owed country B 100 INR with exchange rate of 100 INR – 1 \$, BUT now country A owes country B the same amount but with exchange rate of INR 155- 1 \$. Hence to procure that extra 55 \$ more burden is incurred on country A
- ❖ **Correct points mentioned, but would appreciate more standard disadvbtags, one of them including the government's uncertainty in monetary policies, exchange rate policies, trade strategies, etc**
- ❖ **Not deducting marks though as sufficient number of points with sufficient explanation mentioned**

Possible remedies for the disadvantages:

- ❖ Hedging: Hedging of the currencies at low price creates a safety net once the currency exchange rate increases. **Correct**
- ❖ Reduce external dependence : Creating and boosting the domestic market. **Relevant, but needs further explanation**
- ❖ Central bank : buy or sell foreign currency to limit excessive fluctuations, eg: generally the foreign reserves are depleted or the govt. then sells its bond.**relevant point, but currently unclear and hence require better framing**
- ❖ **[1.5+1.5+1]**
- ❖ **[4/5]**
- ❖ **Good attempt to the question**

Ans2. Marked for review

Was not a difficult question, atleast few points could have been listed out

Ans3. (i) Prices and interest rate are fixed.

$$C = 100 + 0.6 Y$$

$$I = 100$$

$$G = 100$$

$$\text{Exports} = 40$$

$$\text{Import} = 40 + 0.1 Y$$

$$Y = \text{national income}$$

$$Y = C + I + G + X - M$$

$$Y = 100 + 0.6 y + 100 + 100 + 40 - 40 - 0.1 Y$$

$$y = 300 + 0.5 Y \rightarrow Y = 600$$

$$\text{Consumption} = 100 + 0.6 (600) = 100 + 360 = 460$$

$$\text{Trade deficit} = M - X = 100 - 40$$

$$= 60$$

$$\text{Imports} : 40 + 0.1 (600) = 100$$

Correct

(ii) Define J curve. : **a country's trade balance may initially worsen after currency depreciation, then improve over time.**

Initially: Imports become more expensive, while export and import quantities adjust slowly.

Later: Exports may rise and imports fall, improving the trade balance.

Good explanation, as expected by an examiner

(iii) Drivers for the potential globalization of an industry are :

1. Increase in consumer base is required with diverse demand.
2. Cost drivers, the raw material of the product can be procured at less price than what is available domestically. .
3. More incentives for exports from the govt to boost economy and reduce trade deficit.
4. Technological Drivers: Better communication, transport and digital technology.
5. **Correct drivers but they are not standard drivers which are expected here, cost, market, comp and government drivers,**
6. **There is a need to understand the requirement of the question well**
7. **[3+1+0.5+0]**

8. [4.5/7]

iv) marked for review.

Ans 5.(i) Three stages of technological stage are:

- ❖ **Invention:** Creating a new idea, product or process through research and discovery. It is the research & development stage where in the producer or developer may take suggestions from the end consumers, tailoring the technology to optimum level or efficiency at the time of deployment.
- ❖ **Innovation:** Putting the invention into practical or commercial use. this is the deployment and testing stage where in the technology/ goods/ services undergo trials and feedback is taken on the same. Eg: Bug updates of the apps that we receive periodically.
- ❖ **Diffusion:** Spreading and adopting the technology across businesses, industries and society. This involves the large scale deployment of the software/ technology on the industry or enterprise level. Eg : UPI services, which has penetrated the Indian economy at the grass root level.

Perfect answer, only student to get this correct

(ii) Since the Covid – 19 was categorized as a disaster, Govt of India created a national task force to battle its effects that were permeating throughout the country.

The govt can intervene in the following manner in case of such scenarios:

- Introduce **monetary policies** wherein there are **incentives** or subsidies for the industry to invest and produce results via research and development of feasible solutions.
- Reduce the interest rate in case the market stakeholders require loan to procure raw materials. **Need to relate it to the case specific scenario, which is missing**
- Simplify the rules & regulations to copyright the finished goods or to apply for patents.
- Conduct expos or fund raisers with global entities so that the firms can procure major investment deals or MoU's supporting their research & development. (angel – shareholders) , this would also highlight the firm's global presence and open opportunities for globalization. **(this is not a direct govt intervention)**
- Invest and build research infrastructure, employing skilled researchers. **(relevant but insiffucuent explanation)**
- **[3+3.5]**
- **[6.5/8]**

Ans 6. In case the currencies of the India and USA are left as floating exchange rate. Following are the factors that determine the exchange rate:

- **Trade deficit between the countries :** If its positive, the currency of the major exporter would appreciate. Increased Indian exports to the USA raise dollar receipts, strengthening the rupee. Increased imports from the USA raise demand for dollars, weakening the rupee.
- **Capital flow:** More is the investment in the Indian market , more the rupee would appreciate, more the outflow of the capital , more the rupee would weaken.
- **Interest Rate:** Higher interest rates on capital invested, might attract more firms ; investment in the INDIAN market , Eg: FDI in stock market usually boosts the performance of the SENSEX.
- **Inflation:** Higher inflation in India relative to the USA tends to weaken the rupee.
- **Foreign payments (in dollars, yuan, rubel, pounds) boosts the Foreign reserves of the RBI (approx. 740 billion dollars) , wherein they accumulate dollars.**
- **Relative income levels:** Rising income in India may increase demand for American imports, weakening the rupee. Rising US income may increase demand for Indian exports, strengthening it.
- For example, if the exchange rate changes from ₹80 per dollar to ₹85 per dollar, the rupee has **depreciated**, because more rupees are needed to buy one dollar.
- Higher tariff on Indian exports weaken the rupee and the market as a whole. Boosting or stabilizing the domestic USA dollar.
- Speculation regarding the country's growth also attracts investment . Since India is the fastest growing economy, they attract the foreign investment and strengthen rupee.

Question specifically asked for points in long and short run, that distinction is actually missing, which should have been key strcuture of the answer

Some points metioned here are overlapping and should therefore be mixed with their original points, no separate mark is awarded for the same

Apart from that, the points mentioned are generally correct, though some of them has insufficient explanation (such as second last one)

[5/10]

Ans7. During the period of JULY – AUG 2013, where in the rupee went significant depreciation against the US dollar.

i) Possible causes for this depreciation may include :

- Tariff's on the Indian exports that make it difficult for the Indian producers to sell their goods & services in the USA market. Ultimately the USA consumers shift away from the Indian products since they become costlier for them to purchase or consume. (this is more of an indirect cause, not a direct one. So this should not be your first point)
- Higher inflation rates, that discourage consumers to consume the products even domestically hence the money inflow in the money is less. correct
- High repo rate, hence the banks are not able to provide loans to its customer at discounted rate of interests. Wrong and irrelevant as well, you need to relate it to the high/low interest rate in the domestic economy.
- Less amount of investment in technological advancements hampering growth & innovations. . correct

ii) A fixed exchange rate could reduce uncertainty, but it would not automatically solve the economic problems causing rupee depreciation. Under this decision the RBI would keep the rupee fixed against the dollar buying or selling foreign currency.

Advantages :

- Exchange rate stability.
- Control of imported inflation. Higher inflation in India relative to the USA tends to weaken the rupee.
- Predictable foreign debt payments: Bond payout that is made periodically would be in a fixed amount rather than at floating exchange rate. (usually higher) '

Disadvantages:

- Loss of foreign exchange reserves to maintain the set exchange rate.
- Reduced monetary independence
- Risk of an overvalued rupee hence trade deficit would widen.
- Speculative attacks that is the market can become predictable.

All advantages and disadvantages point are correctly stated, just add one more advantage and then perfect answer

[1.5+3.5]

[5/6]

TOTAL: 25/52

Need a lot of improvement and really need to pace up the preparation process as exams are near now

Try focusing on the points mentioned above and improve accordingly

All the best!!