**Macro Economics**

**Jun 2025 Examination**

**PLEASE NOTE: This assignment is application based, you have to apply what you have learnt in this subject into real life scenario. You will find most of the information through internet search and the remaining from your common sense. None of the answers appear directly in the textbook chapters but are based on the content in the chapter**

**Q1. The research team of the Finance secretariat is debating economic policies to address rising inflation and unemployment. A senior economist argues for policies based on Classical Macroeconomic Theory, emphasizing market self-regulation, flexible wages, and full employment in the long run. However, some policymakers are skeptical, citing real-world frictions like sticky wages and government intervention.**

**To support the discussion, the Ministry requests a note on the assumptions of Classical Macroeconomic Theory, helping decision-makers assess its relevance in shaping economic policies. (10 Marks)**

**Ans 1.**

**Introduction**

Classical Macroeconomic Theory has historically shaped the foundation of economic thought and policy formulation. Developed during the 18th and 19th centuries, particularly by economists like Adam Smith, David Ricardo, and John Stuart Mill, the theory promotes a self-regulating economy where markets operate efficiently without government interference. It asserts that supply creates its own demand, and that free markets will automatically adjust to achieve full employment in the long run. While these assumptions held relevance during early industrial economies, modern complexities have led to critical reevaluation. In light of rising inflation and unemployment, the classical theory’s rigid assumptions are being debated. The following note outlines the core assumptions of Classical Macroeconomic Theory to assist the

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**Q2. A country is experiencing rising inflation, slowing consumer demand, and declining investments. You as a member of the research team, have to write a note discussing the impact of inflation on economic growth and how macroeconomic policies can be used to control inflation? (10 Marks)**

**Ans 2.**

**Introduction**

Inflation is one of the most critical macroeconomic challenges that nations face, as it affects prices, purchasing power, consumption, investment decisions, and overall economic stability. In the current scenario, where the country is witnessing rising inflation, a decline in consumer demand, and reduced investment activity, it becomes imperative to understand the relationship between inflation and economic growth. Inflation, if moderate, can stimulate spending and production. However, when it becomes persistent and excessive, it erodes savings, discourages investment, and increases uncertainty. For a country experiencing these economic symptoms, a well-designed macroeconomic policy framework becomes essential. This note explores the impact of inflation on economic growth and outlines the key macroeconomic policy tools that

**Q3A. In a rapidly globalizing economy, countries face challenges like automation, outsourcing, and shifting labor demands. While globalization boosts innovation and market expansion, it also disrupts local job markets and widens skill gaps. Assess the challenges of achieving full employment in a globalized economy? (5 Marks)**

**Ans 3a.**

**Introduction**

Globalization has redefined the world of work by connecting economies, expanding trade, and enabling the free flow of goods, capital, and labor. While this integration fosters innovation and economic growth, it also presents substantial challenges to labor markets. Countries striving for full employment often face difficulties due to automation, outsourcing, and rapid technological advancements. These disruptions increase competition, shift labor demands, and create mismatches between available jobs and workforce skills, making the goal of full

**Q3B. During an economic downturn, a country’s GDP falls significantly, and many businesses close, leading to job losses. As the economy recovers, production rises, and employment improves. Based on the above scenario, explain the relationship between GDP and the unemployment rate within the context of business cycles. (5 Marks)**

**Ans 3b.**

**Introduction**

Gross Domestic Product (GDP) and unemployment are two crucial indicators of an economy’s performance. Their relationship becomes particularly evident during different phases of the business cycle. In a downturn, economic output contracts, businesses struggle, and job losses rise. Conversely, as the economy recovers, increased production leads to job creation and falling unemployment. Understanding this inverse relationship is key to analyzing how macroeconomic fluctuations affect the labor market and to designing policies that stabilize both output and employment.

**Concept and Application**

The relationship between GDP and unemployment is best understood through the lens of the