

Question 1 (20%)

Explain the following terms briefly:

- a) Gross domestic product
- b) Constant returns to scale
- c) Bond
- d) Trade balance
- e) Human capital

Question 2 (40%)

Because of the current war in Ukraine, Ukraine receives massive support from other countries and the countries increase their defense expenditures. Public expenditures increase in the supporting countries.

- a) Use a macroeconomic model to discuss the effect in one supporting country on private investment, private consumption, and total production of increased public expenditures.
- b) The situation implies increased public debt for most countries. Discuss
 - i. Private sector responses to a short-term increase in public debt
 - ii. Long-term consequences of increased public debt-to-GDP ratio

Question 3 (40%)

Consider a world with two countries, **Home** and **Foreign**. Both countries have open economies and flexible exchange rates.

- a) Discuss factors determining imports in the two countries.
- b) Present the interest parity condition.
- c) **Foreign** increases the interest rate. Use a macroeconomic model to discuss how this policy will affect production, private consumption, private investment, export, and import in **Home**.
- d) Use the model to discuss how this policy in **Foreign** will affect production, private consumption, private investment, export, and import in **Foreign**.