1. Using an appropriate diagram, explain clearly why a consumer must be in equilibrium when the marginal rate of substitution is equal to the ratio of the prices of the goods consumed.

1. Use an appropriate diagram; explain how indifference curve analysis can be used to derive a demand curve.

“Developments in the world economy obviously pose a risk to economic performance in the near term. Monetary policy has been eased, in recognition of the changing circumstances, and should prove to have some expansionary influence over the period ahead.”

*From an address by the Governor of the Reserve Bank of Australia to the Economic Society of Australia, Melbourne, 10 April 2001.*

The Governor of the RBA was commenting on the reasons for a change in direction of monetary policy in the early part of 2001 from the contractionary stance taken the previous year (2000). Explain why this change in direction was necessary. USING APPROPRIATE DIAGRAMS, trace the expected impact of contractionary monetary policy on aggregate expenditure, aggregate demand and real GDP, commenting on the implications for economic growth, unemployment, and the balance of payments.

1. Suppose initially a firm is making a profit. **With the use of diagrams**, explain how long run equilibrium is achieved in:
   * Perfect Competition.
   * Monopolistic Competition.
2. Compare the economic welfare of a perfectly competitive industry and a monopoly. Draw the appropriate diagrams and explain how market outcome is different in both industries in regard to output and price.

In the late 1990s, Australia’s current account deficit (CAD) soared to above 6% of our GDP. In early 2000s, the CAD stands at a very comfortable level of just 2% of GDP. Study the following newspaper cutting (Courier Mail, Sept 3, 2001) on the improving CAD and recent strong economic growth:

**Growth rate registers dramatic turnaround**

Despite the weakening world economy, our export receipts are continuing to climb. … Conversely, the sharp resurgence in demand in our economy has yet to have any measurable impact on imports. … The overwhelming reason for such an extraordinary and unexpected turn of events is the super-competitive level of the Australian dollar. …

To the extent that there is a real threat to this outcome, it lies with the inherent uncertainty of the level of the Australian dollar. The dollar cannot remain at such a super-competitive level forever …

*Courier Mail, Sept 3 2001.*

1. Refer to the first paragraph of the press cutting. Describe how the events: “weakening world economy” and “sharp resurgence in demand in our economy” relate to trade balance of our economy. What does it mean when the writer said the Australian dollar is at a “super-competitive” level? Now, explain why, despite the internal and external events in 2001, Australia’s CAD was improving, rather than worsening in that year.
2. In the second paragraph, it says the Australian dollar cannot stay at such a “super competitive level”. Why? Explain **with the use of diagrams.**