UNIVERSITY OF NAIROBI

MODULE II DEGREE PROGRAMME 2011/2012

SECOND YEAR EXAMINATIONS FOR THE DEGREE OF BACHELOR OF COMMERCE

DBA 202: MACROECONOMIC THEORY

DATE: DECEMBER 20, 2012 **TIME: 9.00 A.M. – 11.00 A.M.**

INSTRUCTIONS:
Answer Question ONE and any other ~~THREE~~ Two questions.

Question One

Q1. State whether the following statements are TRUE, FALSE or UNCERTAIN. Using algebraic or graphical illustrations where necessary, provide a short comment in support of your answer.

(i) Equilibrium level of income is such that aggregate demand does not equal output.

(ii) The condition $S = \bar{I}$ is another way of stating the basic equilibrium condition.

(iii) The saving function is expressed as; $S \equiv \bar{c} + (1-c)Y$.

(iv) Investment includes buying a bond or purchasing stocks of a company.

(v) The effect of an income tax is to increase the value of the multiplier.

(vi) The balanced – budget multiplier is always greater than unity.

(vii) Both the IS and LM curves derive from the Keynesian cross model.

(viii) The aggregate supply curve does not reflect conditions in the labour market.

(ix) There is no difference between the short-run and long-run macroeconomic equilibria.

(x) When firms overestimate demand, they have to add the unintended to their inventories and vice-versa. [40 marks]

② $Y = C + I$

Q2. Gross Domestic Product (GDP) is a basic measure of an economy's performance;

(a) Discuss the major principles behind the measurement of GDP.

(b) Distinguish between:
(i) GDP and GNP
(ii) GDP and NDP
(iii) Real GDP and Nominal GDP

(c) Why do countries prefer GDP to GNP in measuring their economy's output?

(d) Discuss the main challenges in the measurement of GDP. [20 marks]

Q3. Consider an expectations' augmented Phillip's curve of the form:

$$\pi_{t+1} = \pi^{e}_{t+1} - \lambda(u^{t} - u^{n}) + \in_{t+1}$$

Suppose that $\lambda = 1$; the natural rate of unemployment is 5%, expected inflation is constant at 2% and that the economy is at full potential:

Required:

(i) Calculate the rate of inflation between the current period and the next period.

(ii) Calculate the inflation cost of lower unemployment assuming rates of 4%, 3%, 2% and 1% respectively.

(iii) Graph and explain the resultant Phillips curve.

(iv) Explain the resultant trade-offs if any. [20 marks]

Q4. (a) Assuming a fairly elastic (conventional) IS curve, assess, using examples from a country of your choice, the implications of the slope of the speculative demand function (l') on the effectiveness of expansionary monetary policy for the following LM curve scenarios:-

(i) a perfectly elastic LM curve
(ii) a fairly elastic LM curve
(iii) a perfectly inelastic LM curve

(b) Derive the monetary policy multiplier. [20 marks]

Q5. The data provided relate to a hypothetical Balance of Payments Account of an African country.

Item	$'000

Receipts from property incomes abroad	200
Government donations to other countries	1,350
Imports of farm machinery	920
Insurance claims from abroad	430
Amortization of foreign loans	200
Communications payment abroad	800
Exports of cocoa	100
Royalties received from abroad	200
Royalties paid to foreigners	980
Exports of tea	200
Exports of pyrethrum	800
External lending by local banks	900
Overseas investments locally	1,400
Imports of crude oil	800
Tourism receipts locally	200
Foreign currency lending abroad	890
Local private investments overseas	980

Required:

(a) Prepare
  (i) The Current Account
  (ii) The Capital Account

(b) Explain ~~how~~
  (i) The disequilibrium arising from (a) above if any.
  (ii) How the resultant disequilibrium if any, can be corrected.

[20 marks]