UNIVERSITY OF NAIROBI

MODULE TWO (DAY AND EVENING)

SECOND YEAR EXAM FOR DEGREE OF BACHELOR OF ECONOMICS

XET202: MACROECONOMICS

DECEMBER 2015. **2HRS**

Answer Question one and any other two

Question1

a) Suppose we have an economy explained by the following functions

$C=50+0.8Yd$

$I=70$

$G=200$

$Tr=100$

$t=0.20$

i)Calculate the equilibrium level of income and the multiplier in the model (8marks)

ii)Calculate the budget surplus(3marks)

iii)Suppose that t increases to 0.25.What is the new equilibrium income? What is the new multiplier?(4marks)

iv)Calculate the change in budget surplus.Would you expect the change in surplus to be more or less if C=0.9 other than 0.8

v)Explain why the multiplier is 1 when t=1(2marks)

b)Define aggregate supply and demand (2marks)

The government increases income taxes.What are the effects on output,prices and interest rate in the short run and long run?(4marks)

Highlight importance of microeconomics (3marks)

Question two

The following equations describe an economy as being measured in billions and j as a percentage; a 5% interest implies j=5

$C=0.8(1-t)Y$.	$L=0.25y-62.5i$
$t=0.25$.	$M/P=500$
$I=900-50i$	
$G=800$	

i)What is the situation that describes the IS curve? (3marks)

ii)What is the general definition of the IS curve (3marks)

iii)What is the equation that describes the LM curve(3marks)
iv)What is the general definition of the LM curve (3marks)
v)What are the equilibrium levels in income and interest rate? (6marks)
vi)Describe in words the conditions that are satisfied at the intersection of the IS and LM curves,and explain why this is an equilibrium (2marks)

Question 3
a)Discuss using the LM-IS model what happens to interest rates as prices change along a given aggregate demand schedule (10marks)
b)Suppose an economy is in recession, how can monetary and fiscal policies speed the recovery.What would happen in the absence of these policies? (10marks)

Question Four
a)Explain the following terms:(12 marks)

i)Nominal and real interest rates
ii)Recession and recovery
iii)Liquidity trap
iv)Crowding out effect
v)Marginal Propensity to save
vi)Full employment

b)Explain four major problems of GDP measurement. (8marks)