CHUKA   **UNIVERSITY**

COLLEGE

UNIVERSITY EXAMINATIONS

SECOND YEAR EXAMINATION FOR THE AWARD OF
DEGREE OF BACHELOR OF COMMERCE

BCOM 202: INTERMEDIATE MACROECONOMICS

STREAM: BCOM Y2S2   **TIME: 2 HOURS**

DAY/DATE: TUESDAY 6/4/2010   **2.30P.M. - 4.30P.M.**

INSTRUCTIONS:

Answer Question One and any other two questions.
Diagrams should be used whenever they serve to illustrate an answer.
Do not write anything on the question paper.

1.   (a)   Explain briefly the following models of Macroeconomics.

              (i)   Monetarism
              (ii)   Supply-side economics
              (iii)   Rational expectation theory.   [9 marks]

       (b)   The following data characterizes the Macroeconomic conditions of a
               hypothetical economy.

                      C = $50 + 0.8Yd$
                      I = 100
                      G = $T = 75$

              Required:

              (i)   Calculate the equilibrium income in the economy.   [2 marks]

              (ii)   What is the value of the Multiplier?   [2 marks]

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(c)   Explain the life cycle hypothesis of consumption.   [5 marks]

(d)   Consider the following Cobb-Douglas production function.

$$Y = A\,K^{\alpha}\,L^{1-\alpha}$$

Required:

(i)   Derive the marginal product of capital.   [2 marks]

(ii)   Work out the desired stock of capital.   [2 marks]

(e)   (i)   What is money Multiplier?   [1 mark]

(ii)   Suppose the reserve ration, $r = 1$ and the currency to deposit
        ratio, $K = 0.2$, Determine the money multiplier.   [2 marks]

(f)   Explain how interest rate is determined in the money market.
                                                        [3 marks]

(g)   What is money illusion?   [2 marks]

2.   (i)   What according to Keynes are motives for holding money. [6 marks]

(ii)   Consider the following investment equation.

$$C = \frac{R_1}{(1+r)} + \frac{R_2}{(1+r)^2} + \frac{R_3}{(1+r)^3} + ... + \frac{Rn}{(1+r)^n}$$

(a)   (i)   What does C and R represent?   [2 marks]

(ii)   Assume $r = 10$, what is the association between this figure,
        C and R?   [1 mark]

(iii)   What is liquidity trap?   [3 marks]

(b)   The commodity market and money market for an economy are defined by the following equation:

Commodity Market

$Y = C + I$

$C = 200 + \dfrac{3}{5}Y$

$I = 1900 - 12r$

Money Market

$M_{DT} = \dfrac{1}{2}Y$

$M_{DS} = 100\text{-}10r$

$M_S = 1500$

(i)   Derive the IS and LM functions for the economy.   [4 marks]

(ii)   What is the equilibrium income and rate of interest for the economy?   [3 marks]

3.   Consider the following consumption function.

$C = 2000 + 0.85Y_d$

Required:

(i)   (a)   Calculate the marginal propensity to consume and marginal propensity to save.   [4 marks]

(b)   What does $0.85Y_d$ represent?   [1 mark]

(c)   What is the autonomous consumption from the above model?   [1 mark]

(d)   How do MPC and APC change with increase in income in the above model?   [2 marks]

(ii) Nyasaland economy is faced with inflation. The main objective is then to slow down the economy. Assuming that you are an economist, advice the Central Bank authorities on how to slow the economy. [6 marks]

(iii) Explain the following two economic policies that influence the working of an economy.

(a) Fiscal policy

(b) Monetary policy [4 marks]

4. (i) Explain the ranges of short-run aggregate supply function. [6 marks]

(ii) Draw the long-run aggregate supply function. [1 mark]

(iii) Distinguish between the actual and potential GDP. [3 marks]

(iv) What do you understand by the term inflationary gap? [3 marks]

(v) Write short-notes on the following:-

(a) Phillips curve

(b) Cost-push inflation

(c) Demand-pull inflation [6 marks]

(vi) Consider the following investment equation.

$$K_t - K_{t-1} = v(Y_t - Y_{t-1})$$

(a) What does the left-hand of the equation represent? [1 mark]

(b) What does v stands for? [1 mark]

(c) Explain the above equation when v = 3. [1 mark]