MACHAKOS UNIVERSITY

University Examinations for 2016/2017

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FIRST YEAR SECOND SEMESTER EXAMINATION FOR DEGREE IN

BACHELOR OF STATISTICS AND PROGRAMMING

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

BACHELOR OF COMMERCE

BACHELOR OF EDUCATION

BACHELOR OF ARTS

EET 101: MACROECONOMIC THEORY I

DATE: 2/6/2017 **TIME: 11:00 – 1:00 PM**

INSTRUCTIONS:

Answer Question ONE and Any Other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Assume a closed economy where the level of I is 300, G=T=150 and the savings function is $S = -30 + 0.15Y^d$ Where S is savings, I is investment, G is government expenditure, T is taxes and Y^d is disposable income.

i) Calculate the equilibrium level of income. (3 marks)

ii) What will be the increase in national income if investment reduces by 25 holding other variables constant? (3 marks)

iii) Suppose government reduced taxes by 100 in this economy, what would be the change in national income? (3 marks)

iv) Illustrate (iii) above using a well labelled diagram of the Keynesian cross. (5 marks)

v) Briefly explain the two types of exchange rate regimes. (4 marks)

b) Using relevant examples, explain the following concepts as used in the circular flow of income in an open economy (6 marks)

a) Injections

b) Withdrawals

c) By use of a graph, explain the meaning of ratchet effect and paradox of thrift (6 marks)

QUESTION TWO (20 MARKS)

a) Differentiate between narrow money (M_1) and broad money (M_2). (4 marks)

b) Why do people hold money when they can earn interest by lending it to others or by buying interest yielding bonds? (6 marks)

c) Through which instruments does the Central Bank of Kenya control money supply? (6 marks)

d) Graphically derive the IS curve (4 marks)

QUESTION THREE (20 MARKS)

a) The following data relate to an emerging African country.

Item	**Value ('000) KSHS**
GNP	8,000,000
Depreciation	100,000
Indirect Business Taxes	80,000
Gross Investment	400,000
Total population	30,000
Consumption	10,000
Personal Income Taxes	800
Excise duty	80
Personal Income	89,000
Net factor incomes from abroad	200,000

Using the above data, calculate:

i)	Net National Product	(2 marks)
ii)	GNP per capita	(2 marks)
iii)	Net investment	(2 marks)
iv)	Disposable personal income	(2 marks)
v)	Gross domestic product	(2 marks)

b) Discuss the main Limitations of National Income Statistics. (10 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the following concepts:

i.	Money (credit) creation (use illustrations)	(4 marks)
ii.	Cyclical unemployment	(2 marks)
iii.	Natural (potential) output	(2 marks)
iv.	Main functions of commercial banks	(2 marks)

b) What measures would you suggest to control inflation in Kenya? (10 marks)

QUESTION FIVE (20 MARKS)

a) Distinguish between short-run aggregate supply and aggregate demand. (4 marks)

b) With respect to aggregate supply and aggregate demand (AS-AD) model, explain economic fluctuations in the economy. Explain the impact of an increase and a decrease in aggregate demand on GDP, price level and unemployment rate in any economy. (10 marks)

c) Discuss any three types of unemployment. (6 marks)