(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2018/2019 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: INTERMEDIATE MACRO-ECONOMICS

COURSE TITLE: ECO 205/ECO311

DATE: 29/05/2019   **TIME:** 9:00 – 11:00 AM

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

ATTEMPT QUESTION ONE AND ANY OTHER TWO

QUESTION ONE

a) Macroeconomics has been described as a study of aggregates. Name and explain some important aggregates whose behaviour is analysed in macroeconomics.   (4 Marks)

b) Given the saving function $S = -10 + 0.2y$ and autonomous investment is Ksh 50(Millions), find

i) The equilibrium level of income and consumption (3 Marks)

ii) if investment decreases permanently by 5 what will be the new levels of income and consumption.   (3 Marks)

c) Explain the life cycle hypothesis by comparing the major differences with the permanent Income hypothesis of consumption.(6Marks)

d) Using the IS-LM Model analyse the impact of an increase in money supply on the equilibrium level of income and rate of interest.   (6 Marks)

e) Distinguish between monetary policy and fiscal policy. Explain the major instruments of monetary policy. Why are these policies frequently ineffective in less developed countries?   (8 Marks)

QUESTION TWO

a) Assume that real GDP (Y) is 1,200. Consumption (C) is given by the equation $C = 125 + 0.75(Y - T)$. Investment (I) is given by the equation $I = 200 - 10r$, where r is the real interest rate in percent. Taxes (T) are 100 and government spending (G) is 150 +250

i) What is the equilibrium value of r?   (4 Marks)

ii) What are the equilibrium values of C and I? 4 Marks)

iii) Now assume government purchases increase by 50 to 200. What are the new equilibrium values of C, I, and r?   (4 Marks)

iv) [3 points] Now assume that we start again at $G = 150$. Suppose a government education program succeeds in getting households to save more. It lowers marginal propensity consume (MPC) to 0.60. What is the new equilibrium value of r?(4 Marks)

v) Suppose that both government purchases (G) and taxes (T) increase by 100. Is r increasing or decreasing? Briefly explain.   (4 Marks)

QUESTION THREE

The product four sector product marked model is given as

$C = 100 + 0.75 (Y - T)$ (Consumption function)

$I = 200 - 2000i$ (Investment function)

$G = 100$

$M = 20 + 0.10Y$ (Import function)

$T = 80 + 0.20Y$ (Tax function)

$X = 50$ (Export function)

$100 + 0.75 \left(Y - (80 + 0.20Y) \right)$

$100 + 0.75 \left(Y - 80 - 0.20Y \right)$

$100 + 0.75Y - 60 - 0.5Y$

$100 + 0.25Y - 60 + 200 - 2000i$

$+ 100 + (50 - (20 + 0.10Y)$

$50 - 20 - 0.10Y$

$2000i$

Ms=200   Md=O.5Y+100-2500r

i)Derive IS function.   (2 Marks)
ii)Find the Lm function   (2 Marks)
iii)Find the equilibrium interest rate and income. (6 Marks)

b)i) Distinguish between monetary policy and fiscal policy.   (2Marks)
ii)Why are these policies frequently ineffective in less developed countries?(8 Marks)

QUESTION FOUR

a)You are an economist working for the Central Bank of Kenya. Use the aggregate demand-aggregate supply model to illustrate graphically your policy recommendation on real output and price level under the following assumptions.   (15 Marks)
i)A reduction in the rate of income tax
ii)A reduction in the level of government expenditure
    iii)Growth and recession

c) Distinguish between expenditure reducing and expenditure switching policies to correct balance of payment disequilibrium.   (5Marks)