KIBABII UNIVERSITY

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UNIVERSITY EXAMINATIONS
2018/2019 ACADEMIC YEAR

MAIN EXAMS

SECOND YEAR SECOND SEMESTER EXAMINATIONS

FOR
BACHELOR OF COMMERCE

COURSE CODE: **ECO 221**

COURSE TITLE: **INTERMEDIATE MACROECONOMICS**

DATE: 19TH NOVEMBER 2020 **TIME:** 9.00AM-11.00AM

INSTRUCTIONS TO CANDIDATES

1. Answer Question One and any Other Two Questions

QUESTION ONE

i) Explain three effects of fiscal policy on IS-LM model. (9 marks)

ii) Explain the theory of liquidity preference (4 marks)

iii) Discuss three reasons why people hold money (6 marks)

iv) a)Define the term LM curve (2marks)

b) Discuss three factors that would cause a shift in the LM curve (9 marks)

QUESTION TWO

Assume the following model of the closed economy in the short run, with the price level (P) fixed at 10: $C = 0.5(Y - T)$ $T = 1,000$ $I = 1,500 - 250r$

$G = 1,500$ $Ms = 1,000$

(a) Write a numerical formula for the IS curve, showing Y as a function of r alone [Hint: Substitute out C, I, G, and T] (5 marks)

$Md = 0.5Y - 500r$, $P = 116$

(b) Write a numerical formula for the LM curve, showing Y as a function of r alone [Substitute out M/P] (5 marks)

(c)What are the short-run equilibrium values of Y, r, and national saving (S)? (5 marks)

(d) Assume that G increases by 1,500 (i.e., G = 3, 000). By how much will Y increase in short-run equilibrium? (5 marks)

QUESTION THREE

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

(a) What is the equilibrium value of r? (5 marks)

(b) What are the equilibrium values of C and I? (5 marks)

(c) Now assume government purchases increase by 50 to 200. What are the new equilibrium values of C, I, and r? (5 marks)

(d) 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? (5marks)

QUESTION FOUR

i) Explain three models of macro-economics (6 marks)

ii) Identify and explain the kinds of inflation (6 marks)

iii) Explain four fiscal measures that can be used to resolve the problem of inflation (8 marks)