



**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**

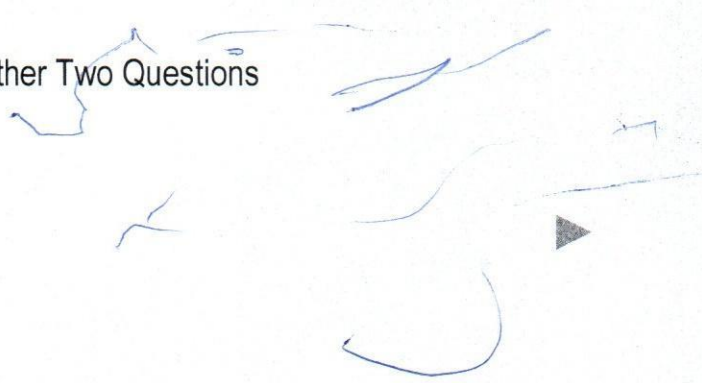
**COURSE TITLE: INTERMEDIATE MACROECONOMICS**

**DATE: 19<sup>TH</sup> NOVEMBER 2020**

**TIME: 9.00AM-11.00AM**

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**INSTRUCTIONS TO CANDIDATES**

1. Answer Question One and any Other Two Questions
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### 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 (2 marks)
- 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:  $C = 0.5(Y - T)$   $T = 1,000$   $I = 1,500 - 250r$

$$G = 1,500 \quad M_s = 1,000$$

- (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)

$$M_d = 0.5Y - 500r, \quad P = 116$$

- (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  $r$ ? (5 marks)

### 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)