KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

MAIN EXAMS

2017/2018 ACADEMIC YEAR

SECOND YEAR SECONDSEMESTER

FOR THE DEGREE OF BACHELOR OF COMMERCE/BACHELOR OF EDUCATION

COURSE CODE: ECO 311/205

COURSE TITLE: INTERMEDIATE MACROECONOMICS

DATE: 08/08/2018   **TIME:** 9.00 -11.00 A.M

INSTRUCTIONS TO CANDIDATES
Answer Question ONE (compulsory) and ANY OTHER TWO questions

SECTION A (COMPULSORY)

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 (2 Marks)

ii)if investment decreases permanently by 5what 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). How does the foreign trade multiplier work? (4 Marks)

SECTION B (CHOOSE ANY TWO QUESTIONS)
QUESTION TWO

a) The following specification describes a certain hypothetical economy.

Investment=100
Government expenditure=75
Net taxes fixed at=100
Consumption=c=25+0.8Yd

Required
i) What is the level of equilibrium income (Y)   (2 Marks)
ii) Calculate the value of equilibrium income if government expenditure rose by25% to 93.75.
                                                                                                        (2 Marks)
iii) Suppose government expenditure changed to 125, what is the government expenditure multiplier?   (2 Marks)

iv) Suppose also that tax fell from 100 to 80,what will be the tax multiplier.(2 Marks)

v) Explain the meaning of government expenditure and tax multiplier calculated in c) and d) above.   (2 Marks)

vi) Derive the saving function from consumption equation.   (2 Marks)

vii) What is crowding out effect? Explain its effect in developing countries?   (8 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)

$\bar{X} = 50$ (Export function)

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.   (10Marks)
i) A reduction in the rate of income tax
ii) A reduction in the level of government expenditure
    iii) Growth and recession

b) Summarise the economic applications of the following models.   (10 Marks)
    i). Harrod Domar model
    ii). Neo-classical growth model
    iii). Solow growth model

QUESTION FIVE
a) The currency exchange rate of a country is affected by local and international factors.
Describe, using clear diagrams, the effect of the following macroeconomic variables on demand for Kenyan shillings on the international market:

    i). Devaluation of the Kenyan shilling
    ii). Increased international demand for Kenyan coffee
    iii). Domestic political insecurity   (5 Marks@15 Marks)
b) Distinguish between expenditure reducing and expenditure switching policies to correct balance of payment disequilibrium.   (5 Marks)