KENYATTA UNIVERSITY
UNIVERSITY EXAMINATIONS 2018/2019
THIRD SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS

**EET 101: MACROECONOMIC THEORY I**

**DATE: WEDNESDAY 31ST JULY 2019** **TIME: 2.00 P.M - 4.00 P.M**

**INSTRUCTIONS: Answer Question One and any other Two Questions**

## QUESTION ONE (COMPULSORY)

(a) Distinguish between the following concepts **(10 marks)**
- (i) Marginal Propensity to import and Average propensity to consume
- (ii) Macroeconomic model and macroeconomic policy
- (iii) Inflationary and deflationary gap
- (iv) Revaluation and depreciation of currency
- (v) Multiplier and accelerator model

(b) The following set of equations describe the economy of country P

| | |
|---|---|
| $Y = C + I + G + X - M$ | *Equilibrium equation* |
| $C = 2000 + 0.8Y^d$ | *Consupmtion function* |
| $I = 3500$ | *Investment* |
| $G = 3700$ | *Government expenditure* |
| $X = 2500$ | *Exports* |
| $M = 400 + 0.3Y$ | *Import equation* |
| $T = 100 + 0.25Y$ | *Tax equation* |

Required
- (i) Compute the equilibrium National income and imports for the country P **(3 Marks)**
- (ii) Obtain the trade balance and describe the position **(2 marks)**
- (iii) Compute the tax multiplier and government policy multiplier **(4 marks)**
- (iv) Based on your results for (iii) above, what policy, between increasing government expenditure and tax cut, will be effective in increasing the country's National income? Give reasons **(3 marks)**

(c) Using well labeled diagrams, describe the Paradox of thrift and Ratchet effect **(8 marks)**

## QUESTION TWO

(a) Explain the various causes of Unemployment in developing countries **(10 marks)**
(b) Describe measures that can be undertaken to reduce unemployment in Kenya **(10 marks)**

## QUESTION THREE

(a) The following information has been extracted from the national income accounting data for country Q in 2007.

| | Kshs. millions |
|---|---|
| National income | 21200 |
| Undistributed corporate profits | 450 |
| Social insurance contributions | 2000 |
| Transfer payments from government and businesses | 3400 |
| Interest payments by government | 300 |
| Personal taxes | 3400 |
| Subsidies | 50 |
| capital consumption allowance | 2900 |
| indirect taxes | 2100 |
| Personal saving | 1500 |

Required
Compute
(i) Gross National Product
(ii) Personal income
(iii) Disposable income
(iv) Personal consumption spending

**(8 marks)**

(b) Explain four limitations of macroeconomics? **(8 marks)**
(c) Outline four objectives of macroeconomic policy **(4 marks)**

## QUESTION FOUR

(a) Clearly distinguish between Demand pull and Cost push inflation (8 marks)
(b) Explain the factors that influence investment decisions in Kenya (12 marks)

## QUESTION FIVE

The commodity and money markets of a hypothetical economy are given as follows:

| | | |
|---|---|---|
| | $Y = C + I$ | *National Income* |
| *Commodity market:* | $C = 100 + 0.6Y$ | *Consumption function* |
| | $I = 1800 - 2.5r$ | *Investment function* |
| | $L_t = 0.2Y$ | *Transactionary demand for money* |
| *Money market:* | $L_{sp} = 10 - 2r$ | *Speculative demand for money* |
| | $Ms = 1000$ | *Money supply function* |

(i) Derive the equations for IS and LM curve and explain what they imply **(8 marks)**

(ii) Obtain the equilibrium level of income and rate of interest **(4 marks)**

(iii) Suppose the central bank of the country increases money supply by 20%, obtain the new levels of national income and interest rates **(5 marks)**

(iv) Give reasons for changes in the level of national income and the rate of interest **(3 marks)**