



KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF COMMERCE, BACHELOR OF EDUCATION AND
BACHELOR OF ECONOMICS

EET 401: MACROECONOMICS THEORY IV

DATE: Thursday, 1st December 2016

TIME: 2.00 p.m. - 4.00 p.m.

INSTRUCTIONS:

SECTION A - COMPULSORY (30 MARKS)

QUESTION ONE

- (a) Discuss the role of liquidity constraint in lifecycle hypothesis. (8 marks)
- (b) Explain how demand function for money is derived using the Friedman theory of money as a consumer and producers goods. (10 marks)
- (c) Discuss the term recardian equivalence theory theoretically and mathematically. (12 marks)

SECTION B - ANSWER ANY TWO QUESTIONS (40 MARKS)

QUESTION TWO

- (i) Assume a consumer's utility function is logarithmic in nature for period t and is also additively separable over time. Assume also that future utilities are discounted at a subjective rate, and for simplicity ignore uncertainty. Derive the expression for intertemporal consumption relations and explain its implication on the consumption path. (12 marks)
- (ii) Show that the slope of the budget line in the two period case of consumption is equal to $-(1 + r)$ and explain its meaning. (8 marks)

QUESTION THREE

Show the development of the flexible accelerator model and show how the change in output is related to the net investment. (20 marks)

QUESTION FOUR

- (a) With the aid of a well labeled diagram and equations, derive the individual and aggregate demand for money function using regressive expectations model. (10 marks)
- (b) In reference to transaction demand for money theory where the consumers are also investors and withdraw cash only for spending and part of their income not withdrawn remain with bankers or brokers in form of bonds. Assuming a representative consumer show the optimal number of transactions formula (the square root rule) and its implications. (10 marks)

QUESTION FIVE

- (a) Derive the basic neoclassical model. (10 marks)
- (b) Derive and explain the optimal growth paths. (10 marks)