



KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF
ECONOMICS

EET 201: MACROECONOMIC THEORY II

DATE: MONDAY 29TH JANUARY 2018

TIME: 4.30 P.M. - 6.30 P.M.

INSTRUCTIONS

1. Question One is Compulsory
2. Answer any other TWO questions

Question One (Compulsory) (30 marks)

- a) Using a country of your choice as an example explain how fixed exchange rates are sustained (4 marks)
- b) Differentiate between automatic and discretionary stabilization (4 marks)
- c) Clearly distinguish between commodity and money markets (2 marks)
- d) Explain the effects of monetary policy in the three ranges of LM curve (6 marks)
- e) Differentiate between income velocity and nominal income (4 marks)
- f) The following equations relate to a certain economy, peruse them and answer the following questions.

$$T = 0.75Y \text{ (tax rate)}$$

$$L = Y - 100r \text{ (Real money demand)}$$

$$M = 300 \text{ (Real money supply)}$$

$$C = 200 + 0.25Y_d \text{ (Consumption function)}$$

$$I = 20 - 10r \text{ (Investment function)}$$

$$G = 30 \text{ (government purchases)}$$

Required

- i) Derive equations from IS and LM curves (5 marks)
- ii) Determine the r and y pair at which the two markets are clearing (2 marks)
- iii) Compute the values of C , I and L . (3 marks)

Question Two

- a) With aid of well labeled diagrams, explain how under the classical model a decrease in the money supply, an increase in income velocity and a fall in the transaction demand for money would affect prices, money wages and real variables (10 marks)
- b) Explain the Relative Income Hypothesis of consumption; compare the major differences of this hypothesis with the permanent income hypothesis of consumption. (10 marks)

Question Three

- a) With aid of well labeled diagrams analyze the impact of lack of use of appropriate technology in the classical model. (8 marks)
- b) Discuss how the government can use the fiscal and monetary policies to determine the direction of economic growth. Base your argument on the four stages of the business cycle. (8 marks)
- c) Explain the difference between the devaluation of a currency and the appreciation of a currency (4 marks)

Question Four

Discuss the tenets held by classical economists in running of the economic affairs. What was Keynes view about running of the economic affairs? (20 marks)

Question Five

Explain clearly using a well labeled diagram (savings and investment curves) the effects of the following.

- a) Investment tax credit (that is a tax exemption to firms that are investing on physical capital) on interest rate and quantity of loanable funds (savings and investment funds) (10 marks)
- b) Government budget deficit on interest rate and quantity of loanable funds. (10 marks)