KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

DIGITAL SCHOOL OF VIRTUAL AND OPEN LEARNING

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ARTS, BACHELOR OF EDUCATION AND BACHELOR OF ECONOMIC AND FINANCES

EET 301: MACROECONOMIC THEORY III

DATE: TUESDAY 19TH JUNE 2018 TIME: 4.30 P.M. – 6.30 P.M.

INSTRUCTIONS

Answer Question ONE and any other TWO questions

QUESTION ONE (30MKS)

a) Given the following equation,

$$y = c(y - t(y)) + i(r) + g$$

$$\frac{m}{p} = l(r) + k(y)$$

i.) Derive graphically and mathematically the IS and LM curves (10mks)

ii.) Show that IS curve is negatively sloped (2mk)

iii.) With the use of a four quadrant diagram, explain the transmission processes that bring about the new equilibrium following the tax cut on income. (8mks)

b) Graphically and mathematically show how a labour demand curve of a competitive market is derived (10mks)

QUESTION TWO (20MKS)

Given the following equations:

Y = C + I + G + X, where; C = 100 + 0.9Y^d (Consumption function), I = 200 – 500r (Investment function), M = 0.8Y – 2000r (Real money demand), X = 100 - 0.12Y – 500r (Net export), G = 200 (Government purchases), T = 0.2y (Tax rate) and L = 800 (Real money supply)

a) Calculate fiscal and monetary multipliers and interpret them (10mks)

b) Assess the effectiveness of Fiscal policy and monetary policy multiplier (10mks)

QUESTION THREE (20MKS)

c) Explain the following macroeconomics concepts (10mks)

i.) Phillips curve

ii.) Potential and actual output

iii.) Okun's law

iv.) Aggregate demand and Aggregate supply

b) Discuss the backward bending of a labour supply curve. (10mks)

QUESTION FOUR 20MKS

a) Using the four-quadrant diagram to discuss the effect of the following on equilibrium interest rate (r) and income (y). (10mks)

i.) An increase in money supply.

ii.) An increase in the price level.

iii.) A decrease of government expenditure

b) Using diagram ,explain the concept of paradox thrift (when planned investment and government expenditure($\bar{i}$) is an increasing function of income(y)

QUESTION FIVE 20MKS

The Government of Kenya, in its macroeconomic policy, aims at achieving high economic growth. The government can influence economic growth by use of fiscal and monetary policy. The government is planning to influence growth by increasing its expenditure. As an economist, the government requests you to explain the effects of such a policy on income, price level, interest rate and employment. Use well-labelled diagrams, paying attention to the transmission processes from initial equilibrium to the ultimate equilibrium. (20 marks)