



MACHAKOS UNIVERSITY

University Examinations for 2022/2023 Academic Year

SCHOOL OF BUSINESS, ECONOMICS AND HOSPITALITY AND TOURISM

MANAGEMENT

DEPARTMENT OF ECONOMICS

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS

BACHELOR OF ARTS

EET 301: MACROECONOMIC THEORY III

DATE:

TIME:

INSTRUCTIONS:

- (i) Answer question one (Compulsory) and any other two questions**
- (ii) Do not write on the question paper**
- (iii) Show your workings clearly**

QUESTION ONE (COMPULSORY)(30 MARKS)

- a) Explain the following concepts as used in macroeconomics: (8 marks)
- (i) Output gap
 - (ii) Okun's law
 - (iii) Paradox of thrift
 - (iv) Monetary Policy Multiplier
- b) Analyze the effect of an increase in the desire to save on equilibrium income and interest rate using the four quadrant diagram (7 marks)

- c) Derive and draw the Labour demand curve for a Monopolist and explain how it differs from the labour demand curve for a perfectly competitive firm (7 marks)
- d) Assuming that there is an increase in government expenditure in the economy, explain how equilibrium is reached in the static short run model with $p^1 < 1$ and $p' = 1$ (8 marks)

QUESTION TWO (20 MARKS)

- a) Analyze the effect of a decrease in the price level on equilibrium income and interest rate using the four quadrant diagram (7 marks)
- b) Explain how workers' expectation about the price are formed in relation to labor supply (6 marks)
- c) Derive aggregate supply curve under the general Keynesian Case (7 marks)

QUESTION THREE (20 MARKS)

- a) Derive the economy's aggregate demand curve (8 marks)
- b) Given the following data for an economy:

$$C = 60 + 0.75Y^d$$

$$T = 0.1Y$$

$$I = 80 - 10r$$

$$G = 100$$

$$\text{Real Money Demand: } L = 0.2Y - 5r$$

$$\text{Real Money Supply: } \frac{\bar{M}}{P} = 65$$

- (i) Derive the fiscal and monetary policy multipliers (7 marks)
- (ii) Compute the fiscal and monetary policy multipliers. Which policy is more effective and why? (5 marks)

QUESTION FOUR (20 MARKS)

- a) Analyze the effect of a decrease in planned investment on equilibrium income when i and g are increasing functions of income (6 marks)
- b) Assuming that there is a sudden exogenous increase in the level of investment demand in the economy, explain how equilibrium is reached in the static short run model:
- (i) Under the perfect foresight model (7 marks)
- (ii) Under the imperfect foresight model (7 marks)

QUESTION FIVE (20 MARKS)

- a) Use the four-quadrant diagram to analyze the effects of the following on y and r
- (i) A decrease in government purchases (6 marks)
 - (ii) An increase in taxes (6 marks)
- b) Derive and explain the signs of the slope of the IS curve and the LM curve (8 marks)