# MACHAKOS UNIVERSITY

**University Examinations for 2018/2019 Academic Year**

**SCHOOL OF BUSINESS AND ECONOMICS**

**DEPARTMENT OF ECONOMICS**

**FOURTH YEAR SUPPLEMENTARY EXAMINATION FOR**

**BACHELOR OF ECONOMIC AND STATISTICS AND**

**BACHELOR OF ECONOMICS AND FINANCE.**

**BACHELOR OF EDUCATION**

**BACHELOR OF COMMERCE**

**BACHELOR OF ECONOMICS**

**BACHELOR OF ARTS**

**EET 201: MACROECONOMICS THEORY II**

**DATE:** **TIME:**

**INSTRUCTIONS TO CANDIDATES**

1. Answer Question **ONE** and any other **TWO** questions
2. **Do not** write on the question paper.

**QUESTION ONE (COMPULSORY) (30 MARKS)**

a) Using diagrams discuss the effect of expansionary monetary policy on three ranges of LM curve. (6 marks)

b) Many developing countries struggle with high unemployment rates. Discuss the effect of and solutions to unemployment in your country. (10 marks)

c) Distinguish the following macroeconomic concepts: (10 marks)

   i) Unemployment and underemployment
   ii) Balance of payment and balance of trade
   iii) Okun's law and Philip's curve
   iv) Autonomous saving and autonomous consumption
   v) Contractionary fiscal policy and contractionary monetary policy

d) Explain why marginal propensity to consume lies between 0 and 1 based on Keynes absolute income hypothesis of consumption. (4 marks)

**QUESTION TWO (20 MARKS)**

**a)** Given the following information:

Money market

Money demand: $(M/P)\ d = L(Y, r) = 5000 + 0.8Y - 1000r$

Money supply $MS/P = 8000$

Goods market

| | | |
|---|---|---|
| Households | $C = 3200 + 0.8Y^d$ | $Y^d = Y - T$ |
| Firms | $I = 400 - 400r$ | |
| Government | $G = 800$ Taxes | $T = 500$ |

Where L(Y,r) represents the demand for real money balances in this economy, MS/P represents the real money supply set by the central bank. Suppose the money market is in equilibrium,

i. Derive the equation for LM curve. (4 marks)

ii. Derive the equation for IS curve. (4 marks)

iii. Compute the equilibrium values of Y (income) and r (interest rate) in this economy. (4 marks)

b) Discuss the determinants of investment expenditure. (8 marks)

**QUESTION THREE**

**a)** Discuss the classical pillar of quantity theory of money. (8 marks)

b) With an aid of well labelled diagrams distinguish between absolute income hypothesis and lifecycle income hypothesis. (6 marks)

c) Using well labelled diagrams explain how a balance of payment deficit would be rectified under fixed exchange rate regime. (6 marks)

**QUESTION FOUR**

a) Compare and contrast any three different macroeconomic views. (6 marks)

b) Discuss any three tools used limit trade in developing economies. (6 marks)

c) Discuss the causes and solution of inflation in your country. (8 marks)

**QUESTION FIVE (20 MARKS)**

a) Using relevant examples from Kenya, discuss any five objectives of monetary policy. (10 marks)

b) Distinguish between the effects of an expansionary fiscal or monetary policy when the economy is at full employment and not at full employment. (10 marks)