



MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS 2020/2021 ACADEMIC YEAR FOURTH YEAR FIRST SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS

BACHELOR OF SCIENCES IN FINANCIAL ECONOMICS), BACHELOR OF SCIENCES IN ECONOMICS AND STATISTICS, BACHELOR OF SCIENCES IN ECONOMICS, BACHELOR OF AGRICULTURAL ECONOMICS, BACHELOR OF ARTS IN AGRICULTURAL ECONOMICS, BACHELOR OF SCIENCES IN PROJECT MANAGEMENT, AND BACHELOR OF COMMERCE

COURSE CODE: ECO 2203

COURSE TITLE: INTERMEDIATE MACROECONOMICS

DATE: 5TH OCTOBER, 2021

TIME: 1100 – 1300HRS

INSTRUCTIONS TO CANDIDATES

Answer Question ONE and any other three questions

This paper consists of 3 printed pages. Please turn over.

Question 1

- a) The Central Bank of Kenya (CBK) is the Kenya's monetary authority with the sole prerogative to vary money supply to attain different macroeconomic policy objectives. Suppose the objective the CBK is to increase the amount of money supply in the economy to stimulate aggregate demand, explain any three tools that it can use. (6 marks)
- b) The goods market for the economy of Cheptongei is defined by the following equations:

Consumption function:	$C = 100 + 0.75Y^d$
Investment Expenditure:	$50 - 25r$
Government Expenditure:	$G = 50$
Taxes:	$T = 50$

Where C = consumption Expenditure, I = Investment Expenditure, and G = Government Expenditure, r = interest rates, and Y^d = disposable income

- i) Derive the IS curve for Cheptongei (4 marks)
- ii) Suppose you are given that Cheptongei's money market is defined by the following equations:

Money demand (liquidity preference):	$L_D = 0.4Y - 80r$
Money Supply:	$M_S = 1200$ Chepts

Where Y = Income, r = interest rate, L_D = Money demand, M_S = Mone supply, and Chepts is the money currency used in Cheptongei.

- Derive Cheptongei's LM Curve (2 marks)
- iii) What is the equilibrium income and rate of interest for the economy (4 marks)
- c) Give a graphical derivation of the IS curve (7 marks)
- d) With examples, differentiate between expansionary and contractionary fiscal policies (2 marks)

Question 2

- a) Using a four-quadrant diagram, illustrate the effect of technology change which increases the demand for labor on the equilibrium employment (N_F), real wage ($\frac{W}{P}$), full employment output (Y_F), price levels (P), and money wages (W). (7 marks)
- b) Give any 2 of Keynes' critique of the classical principles of macroeconomics. (2 marks)
- c) Explain the three motives for holding money by the households according to John Keynes' argument. (6 marks)

Question 3

- a) From a classical economists' perspective, use a diagram to illustrate how any excess supply of funds in the capital markets would be eliminated. (8 marks)
- b) Use a diagram to illustrate the concept of the classical crowding out effect of private investment if the government chose to finance deficit by selling bonds in the private capital markets. (7 marks)

Question 4

- a) Using a diagram, illustrate how a surplus in the Balance of Payment (*BOP*) is corrected under a flexible exchange rate system. (9 marks)
- b) Derive the government expenditure multiplier from the following equations. (6 marks)

$$Y = C + I + G$$

Where Y = National Income, C = Consumption Expenditure, I = Investment Expenditure, and G = Government Expenditure

You are also given that:

$$C = \alpha + \beta Y^d$$

$$I = I_0 - \delta r$$

$$G = G_0$$

$$T = T_0 + tY$$

Where Y^d = Disposable Income, T = Taxes, r = Interest Rates

Question 5

- a) Give any three examples of market rigidities which Keynes alluded to as possible causes of market failure (3 marks)
- b) Use the Saving-Investment (S-I) schedule to demonstrate that, in the presence of interest rate rigidities, automatic stabilization would fail to yield an effective market solution (5 marks)
- c) Use a well-labeled diagram to illustrate how a surplus in the labor market would be corrected to restore the equilibrium from a classical point of view. (7 marks)

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