**KENYATTA UNIVERSITY**

**UNIVERSITY EXAMINATIONS FOR THE DEGREE OF**

**BACHELOR OF ECONOMICS, BACHELOR OF COMMERCE, BACHELOR OF ARTS,**

**BACHELOR OF EDUCATION AND BACHELOR OF SCIENCE**

**EET 101: MACROECONOMICS THEORY 1**

**DATE:** Friday, 12 May 2017 **Time:** 8:00 am – 10:00 am

**INSTRUCTIONS:**

**Answer QUESTION ONE (Compulsory) and any other two questions. Question one carries 30 marks and the rest carry 20 marks each.**

**QUESTION ONE:**

1. Define the following concepts.
2. Inflationary gap
3. Liquidity trap
4. Internal rate of return
5. Marginal propensity to consume.
6. Money illusion
7. The following sets of equations describes the economy of a country a, in Africa.

*C=2000+0.75y^d……………consumption equation*

*I=3600……………………….investment*

*G=3600……………………...government expenditure*

*X=2250……………………...exports*

*M=410+0.3y……………….import equation*

*T=100+0.25y………………tax equation*

Compute the investment multiplier for this open economy. (6 marks)

1. Briefly explain the simplified circular flow of income model (4 marks)
2. Unemployment is a major challenge that affects youth across Kenya. Approximately, 800,000 young Kenyans enter the labour market every year and youth unemployment is estimated to be as high as 35%, compared to the overall national unemployment rate of 10%. Furthermore, 80% of unemployed Kenyans are below 35 years old. Assuming you have been employed by the ministry of labour, explain some of the strategies you will put in place to change this scenario. (10 marks)

**QUESTION TWO**

1. Suppose the marginal propensity to consume is 0.75
2. If the government decreases spending by Ksh 500 billion, what is the change in output? (1 mark)
3. If the government decreases taxes by ksh 500 billion, what is the change in output? (1 mark)
4. If the government decreases transfer payments by ksh 500 billion, what is the change in output? (1 mark)
5. If the government decreases spending by ksh 500 billion and at the same time increase taxes by ksh 500 billion, what is the change in final output? (2 marks)
6. Distinguish between monetary policy and fiscal policy. (5 marks)
7. Explain any five limitations of using per capita income in measuring social welfare. (10 marks)

**QUESTION THREE**

1. Kenya’s economy is normally affected during and after every national election, as a student of macroeconomics what can the government of Kenya do to ensure that the political temperature currently being felt in the country does not affect the economy and preferably investment. What are some of the factors that also determine investment in the country apart from political stability? (10 marks)
2. Clearly distinguish between the different methods of calculating national income. (10 marks)

**QUESTION FOUR**

1. Distinguish between permanent income hypothesis and absolute income hypothesis. (6 marks)
2. With the current drought being experienced in the country coupled with other macroeconomic and political challenges, the country’s inflation rate is expected to rise. The inflation rate was 6.99 in January 2017 and is expected to rise. What are some of the measures that can be put into place to reduce inflation rate just in case inflation rate rose to unacceptable levels?

**QUESTION FIVE**

1. What are some of the challenges experienced when measuring national income? (6 marks)
2. Equilibrium in balance of payments implies that net inflow or outflow of foreign currency is zero. If the economy has a balance of payments deficit, explain the measures that can be instituted to correct it. (5 marks)
3. Explain Keynes motive of holding money. (9 marks)