SOUTH EASTERN KENYA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS/ BACHELOR OF ECONOMICS AND STATISTICS

XET 302: INTERMEDIATE MACROECONOMICS

DATE: 8TH DECEMBER, 2016   **TIME: 1.30-3.30PM**

Instructions to Candidates

a) Answer Question **ONE** and any other **TWO** questions.
b) Begin answering a new question on a separate page on the booklet provided
c) Credit will be given to the clarity of argument and use of local examples.

QUESTION ONE   **(30 marks)**

a) Clearly describe three analytical assumptions underlying national income accounting.

                                                (6 marks)

b) Using diagrams where appropriate, explain the following concepts

   i.   Philips curve   (3 marks)

   ii.   Okun's law   (2 marks)

  iii.   Paradox of thrift   (4 marks)

c) Given equilibrium in the product and money markets, as;

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

       Money market: $\dfrac{m}{P} = l(r) + k(y)$

Required

   i.   Derive the fiscal policy multiplier   (8 marks)

ii.   Given the following equations, calculate and interpret the fiscal policy multiplier

$C = 100 + 0.8Y_d$ (Consumption function)

$I = 10 - 10r$ (Investment function)

$L = Y - 100r$ (Real money demand)

$G = 10$ (Government purchases)

$T = 0.25$ (Tax rate)

$M = 295$ (Real money supply)

(7 marks)

QUESTION TWO   (20 marks)

a) Derive the monetary policy multiplier and interpret it.   (6 marks)

b) Use the four-quadrant diagram to show the effect of the following on equilibrium r and y.

i.) An increase in the desire to save   (7 marks)

ii.) An increase in government purchases   (7 marks)

QUESTION THREE (20 marks)

a) Distinguish between Tax Multiplier and Balanced Budget Multiplier   (4 marks)

b) Explain four factors that may affect the rate of economic growth.   (8 marks)

c) Using a well labeled diagram, explain and graphically show the concept of the steady state of growth in an economy.   (8 marks

QUESTION FOUR (20 marks)

a)   Distinguish between the following terms;

i.   Actual and Potential output   (4 marks)

ii.   Real GDP and Nominal GDP   (4 marks)

b)   Given the following equations for a certain economy:

$Y = C + I + G + X$ (Income identity)

$C = 100 + 0.9Y_d$ (Consumption function)

$I = 200 - 500r$ (Investment function)

$X = 100 - 0.12Y - 500r$ (Net export)

$G = 200$ (Government purchases)

$T = 0.2$ (Tax rate)

$L = Y - 100r$ (Real money demand)

$M = 800$ (Real money supply)

Required

i) Derive equations for IS and LM curves (4 marks)

ii) Determine the r and y pair at which the two markets are clearing (4 marks)

iii) Compute the values of C, I, X and L (4 marks)

QUESTION FIVE   (20 marks)

a) Distinguish between Multiplier and Accelerator concepts (4 marks)

b) Discuss the Solow Growth Model and comment on its application in developing countries. (8 marks)

c) Using IS-LM framework, describe the conditions under which monetary policy is effective (8 marks)