

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

2ND SEMESTER 2023/2024 ACADEMIC YEAR

SECOND YEAR EXAMINATION FOR THE DEGREE
OF COMMERCE AND BACHELOR OF SCIENCE IN
ECONOMICS AND STATISTICS

BCOM -221/ECON .221: INTERMEDIATE
MACROECONOMICS

STREAM: *ECON-STAT, BCOM*

TIME: *2 HRS*

DAY: *THURSDAY [11.30-1.30 P.M]*

DATE: *11/04/2024*

THIS QUESTION PAPER CONSISTS OF FOUR (4) PAGES

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INSTRUCTION:

- (i) Answer **Question One** and other **TWO Questions**
- (ii) Write **succinctly** and **legible**

QUESTION ONE

- a) Differentiate between the following macroeconomics concepts.
 - i. Automatic stabilization and discretionary stabilization. **(2 marks)**
 - ii. Fiscal policy and monetary policy. **(2 marks)**
- b) Kenya operated a fixed exchange rate regime from independent up to 1974. Explain how the country's monetary authorities managed to sustain such a regime. **(4 marks)**
- c) Clearly explain how the relative income hypothesis reconciles short run and long run consumption behavior. **(6 marks)**
- d) Use a well-labeled diagram to explain the effectiveness of monetary policy over the different ranges of the IS-LM framework. **(4 marks)**
- e) The commodity market and money markets for an economy are defined by the following equations:

Commodity market

$$C = 200 + 0.4Y \quad - \quad \text{Consumption function}$$

$$I = 1900 - 12r \quad - \quad \text{Investment}$$

Money market

$$M_{DT} = 0.5Y \quad \text{Money demanded for transaction purpose}$$

$$M_{DS} = 100 - 10r \quad \text{Money demanded for speculative purpose}$$

$$M_S = 1500 \quad \text{Money supply}$$

- (i) Derive the IS and LM functions for the economy. **(4 marks)**
- (ii) What is the equilibrium income and rate of interest for the economy? **(4 marks)**
- (iii) Assume the monetary authority implements an expansionary monetary policy that leads to money supply increasing by 500 (i.e. $M_s = 2000$), by how much will income Y increase in short-run equilibrium? **(4 marks)**

QUESTION TWO

- a) Explain the J-curve phenomenon **(4 marks)**
- b) Briefly explain the factors that may cause disequilibrium in Balance of Payments. **(4 marks)**



- c) With aid of a well labeled diagram explain how the government would solve a Balance of Payment surplus under the following;
- i) Fixed exchange rate **(6 marks)**
 - ii) Flexible exchange rate **(6 marks)**

QUESTION THREE

- a) Why do people hold money balances when they can earn interest by lending it to others or by buying interest yielding bonds? **(6 marks)**
- b) To minimize the impact of COVID-19 pandemic on Kenya’s economy, the Government of Kenya responded by deploying some expansionary fiscal policy tools. State the two tools that were deployed and explain their potential effect. **(4 marks)**
- c) Implementing an expansionary monetary policy is another option which the Government of Kenya should consider in order to spur economic growth and job creation in post-COVID-19 pandemic period. Identify three monetary policy tools and explain how they should be applied by the monetary authority in order to accelerate growth recovery and employment creation. **(6 marks)**
- d) Using a clear diagram, discuss the Pigouvian solution to the problem of unemployment. **(4 marks)**

QUESTION FOUR

- a) In the recent past Kenya has heavily borrowed from the domestic money market to finance her budget deficit. How effective is this financing option in enhancing GDP growth and job creation? Argue your case from the classical point of view. **(8 marks)**
- b) Differentiate between liquidity trap and crowding out effect. **(4 marks)**
- c) With the aid of a well labeled diagram, analyze the impact of an increase in income on interest rate when the economy is at the liquidity trap. **(8 marks)**

QUESTION FIVE

- a) Using classical theory, discuss the effect of the following disturbance in the Kenya’s economy;

- i. The central bank of Kenya decides to increase the money supply. **(5 marks)**
 - ii. There is a decline in technological progress. **(5 marks)**
 - iii. There is decline in population occasioned by an increase in uptake of family planning. **(5 marks)**
- b) Clearly provide a clear argument against the Quantity Theory of Money by J. M. Keynes **(5 marks)**

