MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS
2018/2019 ACADEMIC YEAR
FOURTH YEAR SECOND SEMESTER
THIRD YEAR SECOND SEMESTER

BACHELOR OF ARTS IN ECONOMICS
BACHELOR OF SCIENCE IN ECONOMICS AND STATISTICS
BACHELOR OF SCIENCE IN ECONOMICS
BACHELOR OF SCIENCE IN FINANCIAL ECONOMICS

COURSE CODE: ECO 411/ECO 3203
COURSE TITLE: ADVANCED MACROECONOMICS

DATE: 17TH APRIL 2019 **TIME: 0830 – 1030HRS**

INSTRUCTIONS TO CANDIDATES

Answer Question **ONE** and any other **THREE** questions

This paper consists of 4 printed pages. Please turn over.

QUESTION ONE

(a) Differentiate between the following pairs of terms as used in macroeconomics

(i) Potential GDP and Actual GDP **(10 Marks)**
(ii) Consumer price index (CPI) and Whole price index (WPI)
(iii) Planned Investment and Realized Investment
(iv) Paradox of thrift and Liquidity Trap
(v) Tax Rate Multiplier and Investment Multiplier

(b)

You are given the following information about the money market and goods market for an open economy:

Goods Market

National Income Component	Equation
Investment Expenditure Function	$I = 250 - 400r$
Government Expenditure	$G = 350$
Consumption Expenditure Function	$C = 135 + 0.7Y^d$
Net Export	$X = 150 - 0.12Y - 600r$
Tax Rate	$T = 0.15$

Money Market

Money Market Variables (USD	Equation
Real Money Supply	$M = 700$
Real money demand	$L = Y - 250r$

In the expressions, $r = Interest\ Rate$ and $Y^d = Disposable\ Income$

Required

i. Derive equations for IS and LM curves **3 marks**

ii. Determine the r and y pair at which the two markets are at equilibrium **2 marks**

iii. Compute the values of C, I, X and L **4 marks**

iv. Demonstrate that the National Income Identity - $Y=C+I+G+X$ – holds **2 marks**

v. Compute the slope of the IS and explain why it is negative. **2 marks**

vi. For the money market, what level of interest rates must exist to yield national income of USD 750 million? **2 marks**

QUESTION TWO

(a) Use a combined IS-LM-BP framework to illustrate how a deficit in the balance of payment is corrected under a flexible exchange rate regime. **9 marks**

(b) Explain any three factors that can cause a shift in the BP curve **6 marks**

QUESTION THREE

(a) The equilibrium conditions for the money market and product market for a given economy is given as follows:

Product market :	$y=c(y-t(y))+i(r)+g$
Money market :	$\frac{\acute{M}}{P}=l(r)+k(y)$

Where $y=$¿ real income, $t=$¿ tax rate, $i=$¿ investment expenditure, $g=$¿ government expenditure, $M=$¿ nominal money supply, r interest rate levels, $P=$¿ price levels, $l(r)=$¿ speculative demand for money, and $k(y)=$¿ transactionary demand for money.

(i) Derive the fiscal policy multiplier **4** marks

(ii) Using the following numerical information for the economy, compute the fiscal policy multiplier for whose derivation you did in part (a) (i). **2 marks**

$C=10+0.6Y^d$	Consumption function
$I=50-25r$	Investment function
$L=2Y-100r$	Real money demand
$G=22$	Government purchases
$T=0.20$	Tax rate
$M=300$	Real money supply

(iii) Interpret the fiscal policy multiplier **1 mark**

(b) Assuming a perfect market systems (where there is perfect factor mobility and information flow), use a well-labeled diagram to demonstrate how a surplus in the supply of foreign exchange would be eliminated. **8 marks**

QUESTION FOUR

(a) Using the four-quadrant diagram show the effect of an increase in the desire by households to save on equilibrium interest rates and income in the goods market. **10 marks**

(b) What 2 policies would you recommend for the government to discourage the saving appetite by households? **5 marks**

QUESTION FIVE

(a) Use a well-labeled four-quadrant diagram to illustrate the effect of an increase in price levels on the money market **10 marks**

(b) Reply with ‘TRUE’ or ‘FALSE’ to the following statements (hold all other factors constant) **5 marks**

(i) An increase in interest rate on saving would increase the supply of credit into the money market
(ii) A decrease in the marginal propensity to save (MPS) would increase equilibrium income
(iii) A rise in the interest rates in the money market would result into higher levels of household liquid money balances
(iv) The IS would shift outwards if the interest rates increased
(v) In an open economy, if the domestic interest rates rose relative to the foreign interests, it would trigger capital flight to the foreign markets

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