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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2019/2020 ACADEMIC YEAR
SECOND YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)**

Date: 10th April, 2019
Time: 11.00am – 1.00pm

KFI 202 – INTERMEDIATE MACROECONOMICS THEORY

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) A small open economy with a floating exchange rate is in recession with balanced trade. If policymakers want to reach full employment while maintaining balanced trade, what combination of monetary and fiscal policy should they choose. (6 Marks)
- b) Consider an economy that produces and consumes bread and automobiles. In the following table are data for two years

	2010		2015	
	Quantity	Price	Quantity	Price
Automobile	100	\$50,000	120	\$60,000
Bread	500,000	\$10	400,000	\$20

- i) Using 2010 as the base year, compute
- i) Nominal GDP (2 Marks)
 - ii) Real GDP (2 Marks)
 - iii) The implicit price deflator for GDP (2 Marks)
 - iv) CPI (2 Marks)
- ii) How much have prices changed between 2010 and 2015? Compare the answers given by the Laspeyres and Paasche price indexes. Explain the difference (4 Marks)
- c) Explain the effects of devaluation of a domestic currency on exports and imports (4 Marks)

d) The following is information of Kenyan Adult population by group as at June,2015

Number employed = 10.1 million
Number unemployed = 18.8 million
Adult population = 30 million
Use the above data to calculate

- i) the labor force (2 Marks)
- ii) the number of people not in the labor force (2 Marks)
- iii) the labor force participation rate (2 Marks)
- iv) the unemployment rate (2 Marks)

QUESTION TWO (20 MARKS)

- a) Use the *IS-LM* diagram to describe the short-run and long-run effects of the following changes on national income, the interest rate, the price level, consumption, investment, and real money balances.
 - i) An increase in the money supply. (4 Marks)
 - ii) An increase in government purchases. (4 Marks)
 - iii) An increase in taxes.) (4 Marks)
- b) Suppose the Central Bank of Kenya reduces the money supply by 5percent.
 - i) What happens to the aggregate demand curve (2 Marks)
 - ii) What happens to the level of output and the price level in the short run and in the longrun? (2 Marks)
 - iii) According to Okun's law, what happens to unemployment in the short run and in the long run? (2 Marks)
 - iv) What happens to the real interest rate in the short run and in the long run? (2 Marks)

QUESTION THREE (20 MARKS)

- a) Macroeconomics theory and Models have evolved over time. Discuss the evolution of classical Macroeconomics theory to modern macroeconomic policy debates. (11 Marks)
- b) Discuss the following hypothesis concerning consumption behaviors
 - i) Life cycle hypothesis (5 Marks)
 - ii) The permanent income hypothesis (4 Marks)

QUESTION FOUR (20 MARKS)

- a) Explain and show graphical the overall effect and what happens to output and the general prices owing to expansionary fiscal or monetary policy
 - i) When the economy is at full employment level (4 Marks)
 - ii) When the economy is not at full employment level (4 Marks)
- b) State and Explain eight objectives of macroeconomic fiscal policies (8 Marks)
- c) Define the term "*J- Curve Phenomenon*" (2 Marks)

QUESTION FIVE (20 MARKS)

- a) Highlight six positive and five negative contributions of international trade to Kenya's Economy. (11 Marks)
- b) Use the Mundell–Fleming model to predict what would happen to aggregate income, the exchange rate, and the trade balance under both floating and fixed exchange rates in response to each of the following shocks.
- i) A fall in consumer confidence about the future induces consumers to spend less and save more. (3 Marks)
- ii) The introduction of a stylish line of Toyotas makes some consumers prefer foreign cars over domestic cars. (3 Marks)
- iii) The introduction of automatic teller machines (3 Marks)