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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**UNIVERSITY EXAMINATION, 2024/2025 ACADEMIC YEAR**  
**SECOND YEAR, SECOND SEMESTER EXAMINATION**  
**FOR THE DEGREE OF BACHELOR OF SCIENCE**  
**(BUSINESS ADMINISTRATION)**

Date: 19<sup>th</sup> April, 2024  
Time: 11.30am – 1.30pm

**KFI 202 - INTERMEDIATE MACRO ECONOMIC THEORY**

**INSTRUCTIONS TO CANDIDATES**

**ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS**

**QUESTION ONE (30 MARKS)**

Kenya's economy has undergone significant changes in recent decades, including increased integration into the global economy through trade and financial transactions. Located in East Africa, Kenya has a diverse economy driven by agriculture, manufacturing, services, and tourism. Over the years, the country has experienced fluctuations in its exchange rate regime, transitioning between fixed and flexible exchange rate systems. Attention to both fixed and flexible exchange rates is crucial in understanding Kenya's foreign exchange market. Additionally, Kenya's balance of payments reflects its trade in goods and services, as well as capital flows, remittances and foreign aid through the IS-LM model for an open economy which assesses impact of exchange rate on aggregate demand, investment and trade balance. In this regard, Kenya's balance of payments reflects its trade competitiveness, reliance on imports, foreign investment inflows, and external debt dynamics.

Required:

- a) Use the above extract to answer the following questions
  - i) Distinguish between flexible and fixed exchange rate regime **(2 Marks)**
  - ii) Describe any two key sectors driving Kenya's economic growth. **(2 Marks)**
  - iii) Identify and discuss three components of Kenya's Balance of Payment statement **(6 Marks)**
  - iv) Using IS-LM model for an open economy, show graphically and explain the occurrence of a deficit in the BOP. **(4 Marks)**
- b) Currently Kenya is experiencing skyrocketing in the cost of living coupled with high levels of inflation and the government is struggling on how to implement monetary policies in order to address the situation. As a student of macroeconomics illustrate and explain to the government on which monetary policies to implement to address the shock assuming the economy is not at full employment level **(6 Marks)**
- c) Suppose there is an economic shock that has led to the reduction in investment in the agricultural sector. Illustrate and discuss the effect of the shock on income level of the households and interest rates in the economic assuming money stock remains constant **(6 Marks)**
- d) According to Keynesian economics, household consumption is based on certain principles. Discuss at least two basic principles of relative income hypothesis **(4 marks)**

### **QUESTION TWO (20 MARKS)**

- a) Explain using examples conditions that must hold for an economy to operate at full employment level according to Classical economists **(6 marks)**
- b) Assume Kenyan government has been implementing policies which turn out to be effective. Using a diagram, demonstrate the effectiveness of fiscal policy on the three ranges of the LM-curve **(8 marks)**
- c) Kenya economy currently suffers from excess supply of capital funds leading to a steady rise in interest rates in the economy. Illustrate and explain the measures the monetary authority can implement to mop up the excess capital funds **(6 marks)**

### **QUESTION THREE (20 MARKS)**

- a) Recently Kenya has experienced rapid economic growth occasioned increase in the velocity of money. Illustrate the effect of this on output, wages and price levels in the economy using four quadrant diagram **(10 marks)**
- b) Keynes criticized classical economists' notion of leaving the economy alone to adjust to full employment in case of disequilibrium. Describe the critiques on Say's law **(10 marks)**

### **QUESTION FOUR (20 MARKS)**

- a) Illustrate and discuss the effect of contraction monetary policy when the economy is trapped in liquidity **(6 marks)**
- b) Suppose an economy has experienced increased savings and taxation leading to disequilibrium in the economy. Using a well labelled diagram, show how equilibrium can be restored in the economy **(8 marks)**
- c) Currently the demand for Money has increased in the economy due to other factors apart from the increase in money. Using relevant examples, elaborate on motives for money demand by households in the economy over time **(6 marks)**

### **QUESTION FIVE( 20 MARKS)**

- a) Suppose an economy experiences a surplus in the balance of payment and that it operates a fixed exchange rate regime. Using a well labelled diagram explain how the balance of payment can be corrected **(8 marks)**
- b) The government has aggressively embraced increased taxation to fund its' expenditure. Using the Aggregate demand – Aggregate supply (AD-AS) analysis, illustrate and explain the effect of an increase in taxation on output and employment in the economy. **(8 marks)**
- c) Discuss two policies you would propose to the government of Kenya to address the problem in part (b) above **(4 marks)**