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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR
SECOND YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 10th December, 2024
Time: 2.30pm –4.30pm

KFI 2204 - INTERMEDIATE MACRO ECONOMIC THEORY

INSTRUCTIONS TO CANDIDATES

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

QUESTION ONE (30 MARKS)

Kenya's economy grew at an average of 3.9 per cent between 1997 and 2016 despite recording a downward trend from 2.3 per cent in 1997 to -0.2 per cent in 2000 as a result of decline in all key sectors of the economy due to droughts, deterioration of infrastructure and low aggregate demand. Real GDP per capita recorded a meagre growth, averaging 1.2 per cent between 1997 and 2016. Significant improvement in real GDP per capita growth was witnessed between 2010 and 2019, averaging 2.9 per cent. It is notable that Kenya's economic growth rate is commensurate with real GDP per capita growth, which means that enhanced economic activity is crucial in improving economic welfare. Employment growth in Kenya is slower compared to the GDP growth rate. Total employment growth reveals a downward trend between 2014 and 2019. Overall growth in employment fell from 6.2 per cent in 2014 to 4.9 per cent in 2019 while economic growth averaged 5.6 per cent and increased from 5.4 per cent in 2014 to 6.3 percent in 2018, before decelerating to 5.4 per cent in 2019. The greatest decline was in formal employment, which decreased by 3.2 percentage points from a 5.8 per cent growth in 2014 to 2.6 per cent in 2019. The decline in employment is mainly attributed to a freeze in formal employment by the Government in 2015 to cut on the public sector wage bill. This restricted employment to only essential services such as health, education and security. Assume you are chosen as one of the key policy makers in the country to advice the government towards improving the above highlighted statistics.

a) Using a complete classical model (diagrams) illustrate how your suggestions below will affect this economy:
   i) CBK increasing money supply (4 marks)
   ii) Increasing Kenyan technology (4 marks)
   iii) Decreasing Kenyan population (4 marks)

b) Explain all the policy tools at disposal of the Central Bank that can be used to stimulate the economy and remove it from:
   i) Depression (5 marks)
   ii) Inflation (5 marks)

c) General equilibrium is a central concept in macroeconomic theory and analysis that describes a state where all markets are in equilibrium simultaneously. It's important because it shows how the price system can create order from chaos, even when there's no coordination. The following functions describe a certain economy

$c = 150 + 0.9y^d$; $i=100 - 100r$; $g= 500$; $t= 0.3y$; $l= y - 1000r$; $m = 500$.

Where: c= real consumption expenditure; i= real gross investment; g = real government expenditure; t = real tax revenue; l= real money demand and m = real money supply.

Determine:

i) IS and LM equations (4 marks)

ii) r and y pairs at the equilibrium (4 marks)

QUESTION TWO (20 MARKS)

a) Every country in the world has its own economic strategies to develop their country and to enrich their country. Countries have different economic goals to improve their economic conditions. Every country including Kenya, through its government, will endeavor to achieve these economic milestones. It is very importance for every country to achieve these economic achievements in order for it to be stable and develop fast. Moreover, more foreign investors will invest in such countries. Discuss the main macroeconomic policy objectives that any responsble government will strive to achieve. (8 marks)

b) Using a well labeled diagram, discuss three major parts of Life cycle hypothesis and its applicability in LDCs.

(12 marks)

QUESTION THREE (20 MARKS)

a) The recent government regimes in Kenya have applied both Keynesian and Classical views during the various instances the economy has faced challenges such as growth, macroeconomic instabilities and political issues. Classical and Keynesian economics are two different models of the economy that differ in their views on government intervention, the economy's stability, and how to achieve full employment. Discuss the difference between Real theory of interest by classical and Monetary theory of interest by Keynes

(12 marks)

b) Graphically explain the effects of expansionary monetary policies when the economy is at

i) Full employment (4 marks)

ii) Below full employment (4 marks)

QUESTION FOUR (20 MARKS)

a) Distinguish between the following, macroeconomic concepts:

i) Good and money market (2 marks)

ii) Current account and capital account. (2 marks)

iii) BOP deficit and surplus (6 marks)

b) If the money wage is fixed and individuals cannot accept wage cut, use a diagram to explain the classical remedy to unemployment arising in this case (10 marks)

QUESTION FIVE(20 MARKS)

a) Intuitively examine why unemployment has become an issue of concern in developing countries (12 marks)

b) With the aid well labeled diagrams, describe how a country using a fixed exchange rate system eliminates a deficit in the balance of payment. (8 marks)