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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: 12th August, 2024
Time: 8.30am – 10.30am

KFI 2204 INTERMEDIATE MACRO ECONOMIC THEORY

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

DYNAMICS OF AFRICA ECONOMY

Kenya, a growing economy in East Africa has experienced a mix of robust economic growth and periods of economic strain due to factors like global economic conditions, domestic political stability, and policy decisions. Fiscal policy has been a critical tool for managing economic performance and addressing challenges such as infrastructure deficits, unemployment, and poverty. Over the past two decades, the Kenyan government has increased spending on infrastructure, education, healthcare, and social programs. Some of the key projects include significant investments in roads, railways, and energy projects as well as enhanced funding for free primary education and healthcare initiatives aimed at improving human capital. The government has also adjusted tax policies such as VAT rates and introduced reforms in personal and corporate income taxes to increase revenue and manage fiscal deficits. These expenditures on infrastructure and human capital has contributed to GDP growth by boosting productivity and stimulating demand. Excessive government borrowing to finance these large-scale projects has however raised concerns about long-term debt sustainability and their repayment.

By 2020, the government was allocating a significant portion of its budget to debt servicing, limiting its ability to invest in new projects or respond to economic shocks like the COVID-19 pandemic. A mixed impact on employment has also been witnessed in that employment in the construction sector surged during the peak years of infrastructure development but faced slowdowns as projects were completed and government spending narrowed down. To promote long-term sustainable economic stability and growth, several policy recommendations have been formulated by policy makers to better navigate the trade-offs and opportunities presented by fiscal policy.

Use the case study to respond to the questions that follow

- a) Assume that in the case study the global economic conditions experienced in Kenya has led the economy not operate to at full employment level and the monetary authority has decided to inject more money into the economy to minimize economic strain as a result of infrastructural developments undertaken. Illustrate the effect of this expansionary monetary policy on price and employment level in the economy (6 marks)

- b) The case study have shown that Kenya economy is facing a high levels of youth unemployment due to economic conditions being experienced in the economy due to unpredictable policy decisions undertaken. Assume you are a junior officer in one of the ministries task with implementing the mentioned projects and you have been selected to do a presentation on measures to curb the vice among the youths. Discuss measures you will recommend for the ministry to management youth unemployment. (8 marks)
- c) The projects being carried out in the case study has led the Kenyan economy to face excess liquidity and the Central Bank of Kenya has decided to inject more money into the economy. Illustrate and explain the impact of this action on the liquidity preference section of the money demand curve. (5 marks)
- d) Suppose the Kenyan money market is in equilibrium as demonstrated in the case study and the investment has suddenly increased leading to higher need for funds to implement the projects. Illustrate and discuss the effect on interest level in the economy. (5 marks)
- e) The case study exhibit a case where the Kenyan economy faces a budget deficit and the current regime in Kenya has taken fiscal policy initiatives by increasing tax rates in the economy to finance budget deficit. As a student of macroeconomic, elaborate the effect of the increase in taxation on private consumption and investment in the economy according to classical economists. (6 marks)

QUESTION TWO (20 MARKS)

- a) The following equations describe a certain economy. use the information to answer questions that follow
- | | | |
|--------------------|-------------------|------------------------|
| $C = 300 + 0.8Y^d$ | \longrightarrow | Consumption function |
| $I = 300 - 200r$ | \longrightarrow | Investment function |
| $T = 70 + 0.2Y$ | \longrightarrow | Tax function |
| $G = 100$ | \longrightarrow | Government expenditure |
| $X = 10$ | \longrightarrow | Exports |
| $M = 150 + 0.06Y$ | \longrightarrow | Import function |
| $M^s = 4000$ | \longrightarrow | Money supply |
| $M^D = 0.2Y - 10r$ | \longrightarrow | Money demand |
- Determine;
- IS equation (3 marks)
 - LM equation (2 marks)
 - The level of interest rates and income level at which the economy is at both the good market and money market are at equilibrium (3 marks)
- b) Less developing countries face certain conditions that inhibit growth and prosperity of these countries. Explain common characteristics of these countries (6 marks)
- c) Classical economists and Monetarists believed on automatic stabilization of the economy in any case the economy deviates from full employment level. Discuss three positions of Classical economists held by Monetarists (6 marks)

QUESTION THREE (20 MARKS)

- a) The demand for labour has suddenly increased in the economy. Using a well labelled four quadrant diagram, show and discuss the effect of labour increase on real macroeconomic variables in the economy (10 marks)
- b) Illustrate and discuss why a decline in consumption due to a fall in income occurs through a short-run consumption function as opposed to long-run consumption function according to Duesenberry income hypothesis (10 marks)

QUESTION FOUR (20 MARKS)

- a) Households demand money for various purposes in the economy. Discuss three motive for holding cash balances according to Keynes (6 marks)
- b) Assume Kenya operate fixed exchange regime and that the economy is in a budget deficit. Using a well labelled diagram, explain how the deficit can be eliminated (8 marks)
- c) The interest rates in the economy is fixed above equilibrium level. As a student of macroeconomic illustrate and elaborate consequences of fixing interest rates basing your argument in the capital market (6 marks)

QUESTION FIVE(20 MARKS)

- a) Assume the Kenyan economy is in a slump and the monetary authority has decided to restore the economy using its policy tools. Explain how the tools can be used to stimulate economic activities in the economy (6 marks)
- b) Using a well labelled diagram, show the effectiveness of fiscal policy on the three ranges of the LM curve. (8 marks)
- c) Balance of payment account composed of various items. Explain the components of Balance of Payment account (6 marks)