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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: 9<sup>th</sup> December, 2019  
Time: 2.30pm – 4.30pm

**KFI 202 - INTERMEDIATE MACRO ECONOMIC THEORY**

**INSTRUCTIONS TO CANDIDATES**

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

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**QUESTION ONE (30 MARKS)**

- a) Show from the national income accounting that an increase in taxes (while transfer remain constant) must imply a change in net exports, government purchases, or the saving-investment balance.  
(4 Marks)
- b) Discuss the Lucas expectation theory.  
(4 Marks)
- c) Show that a country that spends more than its income must have an external deficit.  
(4 Marks)
- d) The following equation describes an economy.  $C=0.8(1-t)Y$ ,  $t=0.25$ ,  $I=900-50i$ ,  $\bar{G}=800$ ,  $L=0.25Y-62.5i$ ,  $M/P=500$ .
- i) Define the goods market equilibrium and the money market equilibrium.  
(4 Marks)
- ii) What equation describe the IS and LM curves.  
(8 Marks)
- iii) Describe the condition that are satisfied at the intersection of the IS and LM curves, and explain why this is an equilibrium.  
(6 Marks)

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

Suppose the structural model of an economy is given as follows:  $C=100+0.80Y_d$ ,  $Y_d=Y-T$ ,  $I=100$ ,  $G=100$ ,  $T=100$ . Find the following.

- i) Expenditure multiplier and change in  $Y$  if change in  $G=50$ ,  
(6 Marks)
- ii) Tax multiplier,  
(4 Marks)
- iii) Find national income equilibrium if  $T=50+0.2Y$ .  
(4 Marks)
- iv) Consumption equilibrium,  
(2 Marks)
- v) Tax equilibrium.  
(2 Marks)
- vi) What change in  $G$  will you suggest for increasing national income by 500?  
(2 Marks)

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

- a) Given the following functions:  $C=50+Y_d$ ,  $T=70$ ,  $\bar{G}=200$ ,  $\bar{TR}=100$ ,  $t=0.20$ .
  - i) Calculate the equilibrium level of income and the multiplier.  
(4 Marks)
  - ii) Calculate the budget surplus  
(4 Marks)
  - iii) Suppose that  $t$  increases to 0.25. What is the new equilibrium income.  
(2 Marks)
- b) Discuss the monetary transmission mechanism.  
(10 Marks)

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

- a) Analyze the effects of a reduction in the money stock on the price level and on output when the aggregate supply curve is positively sloped and wages adjust slowly over time.  
(12 Marks)
- b) What happens to the level of real balance as a result of the reduction in the nominal money stock?  
(8 Marks)

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

- a) Discuss why wages move only sluggishly.  
(10 Marks)
- b) Suppose the economy is in a recession. How can monetary and fiscal policies speed the recovery?  
(10 Marks)