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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2024/2025 ACADEMIC YEAR
FIRST YEAR, SECOND SEMESTER EXAMINATION
FOR THE BACHELOR OF ECONOMICS AND FINANCE

Date: 14th August, 2024

Time: 8:30am-10:30am

KFI 2101 MACRO ECONOMICS THEORY

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE - (30 MARKS)

Economic Landscape and Growth

Country Z is a typical developing economy in Africa characterized by several distinctive features and challenges. This country is in the process of transitioning from a low-income, agrarian-based system to a more industrialized and service-oriented structure. With its promising economic potential it is characterized by a mix of traditional and emerging industries, which has made it experience a rapid economic growth. However, this growth has been accompanied by challenges such as population pressure, inadequate infrastructure, and vulnerability to global economic fluctuations. As such it has experienced severe effects of inflation arising due to increased consumer spending, particularly in urban areas, rising global commodity prices and supply chain disruptions and negotiations between labour unions and employers. In addition, Country Z contends with high unemployment rates stemming from a combination of factors, including population growth, insufficient job creation, and challenges in matching workforce skills with available opportunities. As part of its macro-economic goals, this country has decided to adopt a holistic approach that combines monetary, fiscal, and supply-side policies, along with strategic investments in education and infrastructure, so as to achieve a stable and fostering sustainable economic growth through management of inflation and unemployment impacts.

Read the above scenario and answer the following questions;

- a) Country Z experiences high level of unemployment coupled with inflation. Describe how the country can solve the two macroeconomic problems **(4 Marks)**
- b) The inflation being experienced in country Z has reached a level that requirement government intervention. Describe any three types of inflation that can be experienced in Country Z. **(3 Marks)**
- c) Apart from inflation and employment, describe any other two macroeconomic issues that the government of country Z should focus on to ensure economic growth and welfare satisfaction for its citizens. **(5 Marks)**
- d) Explain how population growth, insufficient job creation and challenges in matching workforce skills with available opportunities lead to unemployment in Country Z **(3 Marks)**

- e) Describe any five government policies that can be used to correct the situation in (d) above. **(5 Marks)**
- f) Monetary policy adoption has been mentioned as one of the approaches that can be used to foster economic growth in Country Z. Assuming that the economic growth has deteriorated due to too much money supply in this economy, describe any three monetary policy instruments the government of country Z would use to control this situation. **(6 Marks)**
- g) Assuming the following data on GDP was extracted from the budget records for country Z:
- $$C = 2000 + 0.8Y^d$$
- $$I = 3500$$
- $$G = 3700$$
- $$X = 2500$$
- $$M = 400 + 0.3Y$$
- $$T = 100 + 0.25Y$$
- Use the information to calculate the Gross Domestic Product (GDP) for this country. **(4 Marks)**

QUESTION TWO - (20 MARKS)

- a) Macroeconomics encompasses an analysis to understand functioning of the overall economy. Explain any four areas that fall within the scope of macroeconomics. **(8 Marks)**
- b) Consumption is a central aspect of economic behaviour, hence a number of theories have been developed to explain how individuals and households make consumption decisions. By use of diagrams, describe the Life-Cycle Income Hypothesis **(6 Marks)**
- c) Describe three motives considered when estimating the aggregate demand function for money **(6 Marks)**

QUESTION THREE- (20 MARKS)

- a) Brazilian government has put several restrictions on imports making it operate more of a closed economy than an open economy. Assume that during a certain period of time their level of investment was 400, the government expenditure was equal to taxes at 200 while the savings function was specified as $S = -30 + 0.15Y^d$ where Y^d is the disposable income.
- i) Calculate the equilibrium level of income of Brazil at that time **(5 Marks)**
- ii) What will be the effect on national income if investment increased by 25 units. **(3 Marks)**
- iii) Due to limited revenue, the Brazilian government decided to increase taxes by 130. By how much did the level of their national income change? **(2 Marks)**

- b) Giving examples, explain the following concepts as applied in the circular flow of income model.
- i) Leakages **(2 Marks)**
 - ii) Injections **(2 Marks)**
- c) The balance of payment equilibrium would require the net inflows of foreign currency to be equal to net outflow, otherwise a surplus or deficit can occur in an economy. If the economy experiences a deficit, describe any three measures that can be implemented to address it. **(6 Marks)**

QUESTION FOUR - (20 MARKS)

- a) Every financial year, the finance cabinet secretary must present a summary of the National income statistics to Kenyan citizens. Discuss the significance of conducting this important exercise to the economy. **(8 Marks)**
- b) Keynesian economics emphasizes on the role of consumption in driving economic activity.
- i) Express the mathematical equation for the short-run consumption function, including the key variables and their symbols **(2 Marks)**
 - ii) Show how the savings function can be derived from the consumption function **(3 Marks)**
- c) Investment can be in form of construction of new structures, changes in business inventories or investment in new capital. Describe the term 'Investment' and explain how the following factors influence investment decisions; **(7 Marks)**
- i) Initial cost of the capital good and its useful life
 - ii) Internal rate of Return
 - iii) Invention and innovation

QUESTION FIVE - (20 MARKS)

- a) Kenya implemented a flexible exchange rate regime in 1993 as part of its broader economic reforms aimed at liberalizing the economy, stabilizing the currency, and encouraging foreign investment.
- i) Distinguish between a flexible exchange rate and a fixed exchange rate **(2 Marks)**
 - ii) With reference to flexible exchange rate, describe the J-curve phenomenon and illustrate graphically its inability to eliminate BOP deficit **(6 Marks)**
- b) Assuming a closed economy with no Government Intervention, use relevant equations to derive an LM curve equation and show it on a diagram. **(6 Marks)**
- c) Tom Myles is a sole trader operating a shop in Discovery shopping center located in Muihoko, Ruiru. Assume his sales are on cash basis only describe any three attributes that would make him accept a one thousand shilling note from one of his customers. **(6 Marks)**