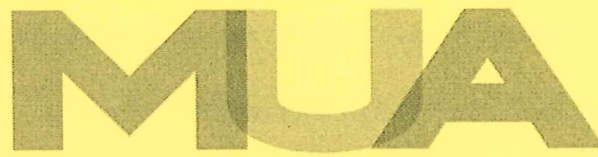


The
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UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR COMMERCE AND BACHELOR OF
MANAGEMENT AND LEADERSHIP

BML 205/ BCM 214: MACROECONOMICS / INTERMEDIATE MACRO ECONOMICS

DATE: 15TH DECEMBER 2022

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

Kenya raises key interest rate to tame inflation

CBK's inflation-targeting Monetary Policy Committee (MPC) said that while the economy shows strong resilience, shocks from food shortages, a weak shilling, and imported inflation in the form of surging food prices could lead to a spike in consumer goods prices if the liquidity is not tightened.

"The Committee noted the elevated risks to the inflation outlook due to increased global commodity prices and supply chain disruptions, and concluded that there was scope for a tightening of the monetary policy in order to further anchor inflation expectations," MPC chairman and CBK governor said after its meeting.

"In view of these developments, the MPC decided to raise the Central Bank Rate (CBR) from 7.00 percent to 7.50 percent."

The Shilling traded at Sh116.71 on Monday -hitting a record low new low against the dollar, setting the stage for costly imported goods such as cars, electronics, farm inputs and second-hand clothes as well as that of electricity amid a shortage of the US currency.

The weakening of the shilling has triggered fears of a fresh round of inflationary pressure, which has become a political headache for the government that has recently been forced to offer fuel subsidies to defuse social tension.

<https://www.theeastafrican.co.ke/tea/business/kenya-raises-policy-rate-to-tame-inflation-3832692>

Required:

- a. "In view of these developments, the MPC decided to raise the Central Bank Rate (CBR) from 7.00 percent to 7.50 percent." Assess the impact of this decision on Kenya's economy. **(2 Marks)**
- b. Identify and expound on three causes of inflation identified in the case study. **(3 Marks)**
- c. Define fiscal policy **(1 Mark)**
- d. From the case study, identify the fiscal policy implemented in the country and explore its impact in the economy. **(2 Marks)**
- e. Contrast between contractionary and expansionary monetary policy and identify which policy was implemented as per the case study. **(5 Marks)**
- f. The case study focuses on one tool of monetary policy, identify and expound on two other monetary tools that would be used to achieve the same objective as the tool discussed in the case study. **(4 Marks)**
- g. Propose four effects of inflation on an economy. **(8 Marks)**

QUESTION TWO

- a. Define the following terms: **(4 Marks)**
 - i. Balance of trade

- ii. Potential GDP
- b. Suppose that in an economy with no government the aggregate expenditure function is: $AE = 50 + 0.75Y$ with an investment level of 100.
- i. Determine the level of planned expenditure when income is 150.
(2 Marks)
 - ii. Draw a diagram showing the aggregate expenditure function (3 Marks)
 - iii. What are the levels of autonomous consumption and induced consumption at income levels of 150 and 200.
(2 Marks)
- c. An open economy with a government sector is in equilibrium. Assume the following:
1. Marginal propensity to save = 0.4
 2. Marginal propensity to tax = 0.2
 3. Marginal propensity to import = 0.2
 - i. Solve for the value the government multiplier (1 Mark)
 - ii. Determine by how much the equilibrium level of national income would fall, if injections in the economy are reduced by Ks.60m.
(1 Mark)
 - iii. Determine the new level of income if taxes increased by KS. 20
(2 Marks)

QUESTION THREE

a. Below is hypothetical data for a country Z.

Government purchases \$120 billion

Depreciation \$40 billion

Consumption \$400 billion

Business Investment \$60 billion

Exports \$100 billion

Imports \$120 billion

Indirect taxes \$1 billion

Income receipts from rest of the world \$10 billion

Income payments to rest of the world \$8 billion

Population is 5 million

Required:

- i. Solve for the value of GDP (4 Marks)
 - ii. Calculate the NNP (2 Marks)
 - iii. Determine the value of per capita income (2 Marks)
- b. Assess the contradicting objectives of macroeconomic policy. (6 Marks)
- c. Define the natural rate of unemployment (1 Mark)

QUESTION FOUR

- a. Consider the demand side characterized by the following consumption, investment and real money balances demand functions.

$$\text{Net exports} = 100$$

$$\text{Government expenditures} = 50$$

$$C = 25 + \frac{Y}{2}$$

$$I = 25 - \frac{r}{2}$$

$$M^D = 0.4Y - 1000r$$

$$M^S = 5000$$

- i. Derive the IS and the LM equations **(6 Marks)**
 - ii. Solve for the equilibrium level of income and interest rate **(3 Marks)**
- b. Propose six reasons why economists should not consider GDP an effective measure of the standard of living in a country. **(6 Marks)**

QUESTION FIVE

- a. A country with a population of eight million adults has five million employed, 500,000 unemployed, and the rest of the adult population is out of the labor force. Calculate the unemployment rate **(2 Marks)**
- b. Explain the Life Cycle Income Hypothesis theory of consumption. **(8 Marks)**
- c. Define the Balance of Payments (BOP) and state its components. **(5 Marks)**

QUESTION SIX

- a. "Kenya's inflation rate rose to 6.1 per cent in 2021, the highest since 2018. In 2020, the inflation rate stood at 5.4 per cent. Kenya's currency, the shilling, in 2021 traded at an average of Sh109.70, compared to Sh106.50 in 2020. In 2021, the number of jobs in the public sector rose to 923,075 from 884,600 the previous year. In the private sector, jobs stood at 1.9 million in 2021, compared to 1.8 million in 2020. The increase in the number of jobs points to a gradually recovering economy." From this excerpt argue the case for the Philips curve phenomenon. **(6 Marks)**
- b. "According to the Economic Survey 2022, Kenya's balance of trade deficit widened from Sh999.9 billion in 2020 to Sh1, 407.6 billion in 2021." Advise the government on how it can tackle the trade deficit. **(6 Marks)**
- c. Highlight Keynesian motives for money. **(3 Marks)**

