CHUKA   **UNIVERSITY**
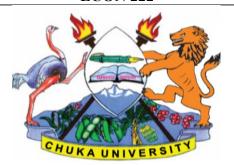
UNIVERSITY EXAMINATIONS

SECOND YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF SCIENCE IN ECONOMICS STATISTICS, ECONOMICS SOCIOLOGY, BACHELOR OF COMMERCE, ENTREPRENEURSHIP, AGRIBUSINESS MANAGEMENT, AGRICULTURAL ECONOMICS, BA GENERAL, ECONOMICS & MATHEMATICS

ECON 222: INTERMEDIATE MACROECONOMICS

STREAMS: "AS ABOVE"   **TIME: 2 HOURS**

DAY/DATE: WEDNESDAY 15/04/2020   **8.30 A.M. – 10.30 A.M.**

INSTRUCTIONS:

QUESTION ONE

(a)   Given the following equations for a certain economy

$C = 100 + 0.9Yd$ (Consumption function)

$I = 200 – 500r$ (Investment function)

$X = 100 – 0.12 Y – 500r$ (Net export)

$G = 200$ (Government purchases)

$T = 0.2$ (Tax rate

$L = Y-100r$ (Real money demand)

$M = 800$ (Real money supply)

Required:

(i)   Derive equations for IS – LM curves   [6 marks]

(ii)   Determine the r and y pair at which the two markets are clearing   [2 marks]

(iii)   Compute the values for C and X   [2 marks]

(iv)   Suppose government purchases increases to 300, what would be the change in equilibrium income?   [3 marks]

(v)   Show whether this country is experiencing trade balance, deficit or surplus. Show your working   [2 marks]

(b)   What is a liquidity trap? How does its existence make the expansionary monetary policy ineffective atimes of depression?   [6 marks]

(c)   The Phillips curve relationship holds only in the short-run. There exist either no or weak relationship between inflation and unemployment in the long-run. Explain   [7 marks]

(d)   Differentiate between the following terms   [2 marks]
        Inflationary and deflationary gaps

QUESTION TWO

(i)   Demonstrate using classical model, how a decrease in money supply, decrease in income velocity and a rise in the transaction demand for money would affect prices, money wages and real variables in an economy.   [15 marks]

(ii)   Illustrate the concept of Ratchet effect   [5 marks]

QUESTION THREE

(i)   The table below shows the projected cash flow of project X with initial investment of 240 million

Year	Project cash flow "million"
1	70
2	90
3	110
4	80

        The project cost of capital is 10%

Required:

        Using concept of Net Present Value, determine if the project is viable or not.   [3 marks]

(ii)   Discuss the accelerator theory of investment   [5 marks]

(iii)   Using the IS-LM model, analyze the impact of change in money supply on the equilibrium level of national income and rat e of interest rate.   [12 marks]

QUESTION FOUR

(a)   Clearly discuss the need for government intervention in an economy.   [5 marks]

(b)   Discuss the following concepts

      (i)   Real theory of interest   [5 marks]

      (ii)   Wage and price flexibility   [5 marks]

      (iii)   Rational expectation theory   [5 marks]

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