

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF MASTERS OF SCIENCE IN
ECONOMICS

MSEC 821: ADVANCED MACRO ECONOMICS

STREAMS:

TIME:3 HOURS

DAY/DATE: THURSDAY 13/04/2023

2.30 P.M. –5.30 P.M.

INSTRUCTIONS

ANSWER QUESTIONS ONE AND NAY OTHER THREE QUESTIONS

QUESTION ONE (15 marks)

Consider equilibrium level of national income, y_e given by,

$$i + g = s(y) + t(y)$$

Where, i = planned investment

Required:

- a) Show that the above equilibrium y_e is a stable equilibrium thus any disturbance of y moving away from y_e will be followed by movement back towards y_e through inventory mechanism (8 marks)
- b) Show that private investment in national income accounts are by definition equal to the sum of private saving and government saving. (4 marks)
- c) Given that $y = c(y - t) + i + g$
Show that the balanced budget multiplier is equal to 1 (3 marks)

QUESTION TWO (15 marks)

- a) Briefly explain the following models of macroeconomics
- i. Real business cycle (5 marks)

- ii. Rational expectation theory (5 marks)
- iii. Explain the main implications of the Neo-classical macroeconomic thought (5 marks)

QUESTION THREE (15 marks)

- a) Both monetary and fiscal policies are demand management policies. Using diagrams show and explain how the two policies can be used to regulate the level of economic activity in a country. (7 marks)
- b) An economy is in equilibrium if the change inventory equals zero. Using saving investment balance shown and explain.
 - i. The equilibrium of the economy (4 marks)
 - ii. The equilibrium of the economy if the desire to save decreases. (4 marks)

QUESTION FOUR (15 marks)

- a) Given that an individual lives for two periods and that he inherits no asset and leaves no bequest,
 - i. Show that savings in period one equals the opposite of savings in period two. (4 marks)
 - ii. Show graphically and explain his inter temporal budget constraint (4 marks)
- b) What happens to budget constraint if;
 - i. The individual starts life with an asset (4 marks)
 - ii. The individual lives for more than two periods (3 marks)

QUESTION FIVE (15 marks)

- a) Using Mundell-Fleming model, explain the effectiveness of monetary and fiscal policy in influencing aggregate income of an economy under the flexible exchange rate. (7 marks)
 - b) Explain the following models of investment
 - i. The accelerator model (4 marks)
 - ii. Adjustment cost approach (4 marks)
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