



**KENYATTA UNIVERSITY**

**UNIVERSITY EXAMINATIONS 2011/2012**

**SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS**

**EET 201: MACROECONOMIC THEORY II**

**DATE:** Tuesday 28<sup>th</sup> March, 2012

**TIME:** 2.00 p.m. – 4.00 p.m.

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**INSTRUCTIONS**

Answer *Question one* and any other *Two* questions.

**QUESTION ONE (COMPULSORY)**

a) Compare and contrast the significance of the demand management policies under the following schools of thought:

i) Keynesian theory [3 marks]

ii) Classical theory [3 marks]

b) Using a country of your choice as an example explain how fixed exchange rates are sustained. [5 marks]

c) Given the following equations for a certain economy

$C = 100 + 0.8Y^d$  (Consumption function)

$I = 10 - 10r$  (Investment function)

$G = 10$  (Government purchases)

$T = 0.25Y$  (Tax rate)

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

$M = 295$  (Real money supply)

**Required**

i) Derive equations for IS and LM curves. [5 marks]

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

iii) Compute the values of  $C$ ,  $I$  and  $L$ . [3 marks]

- d) In order to demonstrate your understanding of the Keynesian theory. Systematically discuss the contribution of Keynes to the theory of money. [9 marks]

**QUESTION TWO**

Explain through the use of short notes the foundations of classical model and provide a clear argument against each as provided by John M. Keynes. [20 marks]

**QUESTION THREE**

- a) Explain the difference between the devaluation of a currency and the appreciation of a currency. [4 marks]
- b) Using well labeled diagrams, analyze the impact of an increase in money supply in the classical model. This should be followed by a detailed explanation. [8 marks]
- c) With aid of well labeled diagrams analyze the impact of investments in ICT in the classical model. [8 marks]

**QUESTION FOUR**

- a) Compare and contrast the capital account and the current account of the balance of payments. [4 marks]
- b) Clearly distinguish between commodity and money markets. [4 marks]
- c) Explain the J-curve phenomena. [5 marks]
- d) Explain the effects of monetary policy in the three ranges of LM curve. [6 marks]

**QUESTION FIVE**

- a) Using well labeled diagrams explain the adjustment to balance of payment deficit under flexible exchange rate. [10 marks]
- b) Using well labeled diagrams explain how balance of payment surplus under fixed exchange rate would be rectified. [10 marks]

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