PAN AFRICA CHRISTIAN UNIVERSITY

SCHOOL OF LEADERSHIP, BUSINESS & TECHNOLOGY

END OF SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

JANUARY-APRIL 2019 SEMESTER

CAMPUS: ROYSAMBU

DEPARTMENT: BUSINESS STUDIES

COURSE CODE: BCM300

COURSE TITLE: INTERMEDIATE MACRO ECONOMICS THEORY

EXAM DATE:WEDNESDAY 10th APRIL 2019

DURATION: 3 HOURS

TIME: 2:00PM-5:00PM

INSTRUCTIONS

- Read the instructions and questions carefully before you write the answers.
- Write your **STUDENT NUMBER** in the Answer Booklet given
- *Write clearly and legibly.*
- This examination script consists of **Six(6)** questions.
- Answer Question **ONE** and any other**FOUR**questions
- *ALL PAC University's examination rules and regulations apply*

QUESTION ONE: COMPULSORY[40MKS]

(a) Distinguishthe following pairs of terms:

(i) Involuntary unemployment and natural rate of unemployment [4mks]

(ii) Fixed exchange rate and flexible exchange rate [4mks]

(b) Suppose that the money demand function of an economy is given by

$$(M/P)^d = 1000 - 100r$$

where r is the interest rate in percentage. The money supply is 1000 and the price level is 2.

(i) Graph the supply and demand for the real money balances. [4mks]

(ii) Determine the equilibrium interest rate. [2mks]

(iii) Assume that the price level is fixed. Calculate the equilibrium interest rate when the supply of money is increased from 1,000 to 1,200. [4mks]

(c) Consider an economy described by the following consumption function:

$$C = \alpha + \beta Y$$

(i) Write down a mathematical expression of the savings function. [3mks]

(ii) Graph the savings function. [2mks]

(d) Using appropriate diagram, describe the circular flow of income in an economy with only households and firms. [7mks]

(e) Discuss five reasons why GDP is not considered a good measure of material well-being of the people in a country. [10mks]

QUESTION TWO [15MKS]

Suppose a hypothetical economy produces only 3 different goods; maize, rice and beans. The following table shows theprices and quantities of each good produced in 2015, 2016, and 2017.

Year	Price of Maize ($)	Quantity of Maize (bags)	Price of rice ($)	Quantity of rice (bags)	Price of beans ($)	Quantity of beans (bags)
2015	7	400	8	225	10	175
2016	8	550	7	250	12	275
2017	9	900	6	275	15	275

Calculate:

(i) The nominal GDP for each year. [5mks]

(ii) The real GDP for each year using 2010 as the base year. [5mks]

(iii) The GDP deflator for each year. [5mks]

QUESTION THREE [15MKS]

(a) Distinguish between discretionary versus automatic stabilizers in reference to economic fluctuations. [4mks]

(b) Explain how fiscal and monetary policies can be used to influence the economy during:

(i) The period of slow economic growth [5mks]

(ii) The period of high inflation [6mks]

QUESTION FOUR [15MKS]

(a) An economy is described by the following equations:

$$Y = C + I + G$$
$$C = C_0 + bY$$
$$I = I_0$$
$$G = G_0$$

(i) Find the equation for the equilibrium level of income. [4mks]

(ii) Suppose $C_0 = 135, b = 0.8, I_0 = 75, G_0 = 30$. Solve for the equilibrium level of income. [4mks]

(b) Discuss the life cycle income hypothesis. [7mks]

QUESTION FIVE [15MKS]

(a) Use a diagram to differentiate between the IS and LM curves. [5mks]

(b) Using the diagram in (a) above, explain the effect of:

(i) Expansionary monetary policy on the IS-LM curve. [5mks]

(ii) Expansionary fiscal policy on the IS-LM curve. [5mks]

QUESTION SIX [15MKS]

(a) Using diagrams, discuss the terms demand-pull inflation and cost-push inflation. [10mks]

(b) Briefly explain the disadvantages of inflation to the domestic economy. [5mks]