



STRATHMORE BUSINESS SCHOOL (SBS)
BACHELOR OF COMMERCE/BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BCM 1203/BFS 1204: INTRODUCTION TO MACROECONOMICS

DATE: 19TH APRIL 2021

Time: 2 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE (30 MARKS)

- (a) Consider a macroeconomy that only produces tablets and smart phones. Use the information below to answer the following questions.

Product	Quantity(thousands)		Price (hundreds of dollars)	
	2010	2015	2010	2015
Tablets	50	70	20	40
Smart Phones	50	80	10	15

- i. Calculate nominal and real GDP for 2010 and 2015 using 2010 as the base year.

(3 Marks)
- ii. What is the approximate real economic growth rate in the economy over this period?

(2 Marks)
- iii. Assuming that the quantities in the table also represent the typical consumer's basket of goods, calculate the GDP deflator and CPI for 2010 and 2015 using 2010 as the base year

(4 Marks)

- (b) An article published in an economics journal found the following: “For the poorest households, the marginal propensity to consume was close to 70%. For the richest households, the MPC was only 35%.” Assume that the macroeconomy can be divided into three sections. Section A consists of the poorest households, Section B consists of the richest households, and Section C of all other households.
- (i) Compute the value of the multiplier for section A. **(2 Marks)**
- (ii) Assume that there was an increase in planned investment of \$4 billion. Compute the change in equilibrium real GDP if the MPC for the economy was 70 percent. **(3 Marks)**
- (c) Suppose you withdraw \$1,000 from your savings account and put it in your checking account. Briefly explain how this will affect M1 and M2. **(3 Marks)**
- (d) Briefly explain three reasons why the aggregate demand curve slopes downward. **(6 Marks)**
- (e) The headline on an article in the New York Times was “Unemployed in Europe Stymied by Lack of Technology Skills.” Are these workers likely to be cyclically, frictionally, or structurally unemployed? Briefly explain. **(3 Marks)**
- (f) Briefly describe the transactions included in a country’s current account. **(4 Marks)**

QUESTION TWO (20 MARKS)

- (a) Explain and show graphically how government deficits can "crowd out" private investment. (Hint: Use the loanable funds model) **(6 Marks)**
- (b) Consider the following goods market

$$C = 500 + 0.5Y_D$$

$$I = 100$$

$$T = 80$$

$$G = 200$$

- (i) Solve for the goods market equilibrium. (Find equilibrium output (Y), aggregate (Z), Consumption (C), and disposable income (Y_D)). **(6 Marks)**

(ii) Solve for the private saving and public saving. **(4 Marks)**

(iii) Find the multiplier and autonomous spending. Explain what they mean. **(4 Marks)**

QUESTION THREE (20 MARKS)

(a) “Explaining why living standards vary so much around the world is, on one sense, very easy. The answer can be summarized in a single word- productivity. In light of this statement, identify any four drivers of productivity in any economy and explain how public policy can promote productivity via those drivers **(12 Marks)**

(b) Assume that OPEC starts enforcing oil production quotas and the global supply of oil declines. As a result, energy prices starts to increase. This causes the costs of production for Kenyan firms to increase. Use the AD-SRAS-LRAS diagram to describe the transition of the macroeconomy from the short-run to the long-run without government intervention. **(8 Marks)**

QUESTION FOUR (20 MARKS)

(a) Discuss the three policy tools a Central Bank uses to manage the money supply. (Remember to explain how each tool increases/decreases money supply). **(12 Marks)**

(b) An article in the *Economist* notes that the government of Venezuela running a large budget deficit “caused the money supply almost to quadruple in two years and led to the world’s highest inflation rate, of over 60% a year”

(i) Why would running a large budget deficit cause the money supply in Venezuela to increase so rapidly? Explain. **(3 Marks)**

(ii) If the money supply increased by 150 percent per year (or 300 percent over two years) while the inflation rate was 60 percent, what must have happened to velocity in Venezuela during this period. **(5 Marks)**

QUESTION FIVE (20 MARKS)

(a) Paul De Grauwe, an economist at the London School of Economics, wrote in the *Economist* that the quantitative easing policies of the European Central Bank “will contribute to a further weakening of the Euro vis-à-vis other currencies such as the dollar, the pound and the Yuan, thereby increasing exports and boosting inflation.”

i. What does De Grauwe mean by “a weakening of the euro”? **(2 Marks)**

ii. What is quantitative easing, and why should it lead to a weakening of the euro?
(6 Marks)

iii. If you ran a business in France that exports to the United States and Japan, would this development help you? If you were a customer in France, would this development help you? explain
(4 Marks)

(b) An article in the *Wall Street Journal* about China's balance of payments contained the following observations: A country's balance of payments still has to add up to zero. If foreign investors wish to acquire assets denominated in yuan, the necessary implication is that China will have to run a trade deficit."

(i) Do you agree that the balance of payments must add up to zero? Briefly explain
(3 Marks)

(ii) If China were to have a deficit in its balance of trade of -100 billion yuan, must it have a surplus in its financial account of +100 billion yuan? Briefly explain.
(5 Marks)