



STRATHMORE BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION

BFS 1204: INTRODUCTION TO MACROECONOMICS

DATE: Tuesday 3rd December 2024

TIME: 13:00 – 15:00

Instructions

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

QUESTION ONE

(30 Marks)

- a) Given the following data for a hypothetical economy (in billions of dollars):

| | |
|---------------------------------------|-------|
| Consumption Expenditure (C): | 1,500 |
| Investment (I): | 500 |
| Government Spending (G): | 600 |
| Exports (X): | 300 |
| Imports (M): | 200 |
| Depreciation: | 100 |
| Net Factor Income from Abroad (NFIA): | -50 |
| Indirect Taxes: | 150 |
| Subsidies: | 50 |
| Corporate Taxes: | 200 |
| Social Security Contributions: | 100 |

| | |
|----------------------------------|-----|
| Transfer Payments: | 300 |
| Undistributed Corporate Profits: | 50 |
| Personal Taxes: | 400 |

Using the data provided, compute the following:

- i. Gross National Product (GNP) **(3 marks)**
 - ii. National Income (NI) **(3 marks)**
 - iii. Personal Disposable Income (PDI) **(3 marks)**
- b) Distinguish between real interest rate and nominal interest rate and explain why inflation expectations play a critical role in determining the real rate of interest. **(5 marks)**
- c) Highlight **four** reasons why managing national debt is a critical policy concern in developing countries. **(4 marks)**
- d) Analyze the economic consequences of a domestic currency appreciation on the following:
- i. Exports and imports **(2 marks)**
 - ii. Inflation and purchasing power **(2 marks)**
 - iii. Balance of payments **(2 marks)**
- e) Identify **three** causes of cost-push inflation in an economy. **(3 marks)**
- f) The marginal propensity to consume (MPC) for a hypothetical economy is 0.25. The level of investment in this economy increases by 10 million shillings.

Required: Holding other factors constant, calculate the change in the equilibrium level of income. **(3 marks)**

QUESTION TWO **(20 marks)**

- a) Analyze **five** potential challenges that central banks in developing countries face when implementing monetary policy in the current economic environment. **(10 marks)**
- b) Consider an economy described by the following labor market model:
 - Labor force (L): 20 million

- Employed workers (E): 18 million
- Unemployed workers (U): 2 million
- Natural rate of unemployment (u^*): 5%

Required:

- Calculate the actual unemployment rate (u) and compare it to the natural rate of unemployment (u^*). **(3 marks)**
- Suppose the government introduces a job creation program that increases the number of employed workers by 0.5 million. Calculate the new unemployment rate and analyze the program's effectiveness in reducing unemployment. **(3 marks)**
- Assuming Okun's Law holds with a coefficient of -2, estimate the effect of reducing unemployment by 1 percentage point on GDP growth. Explain the significance of Okun's Law in the context of unemployment and economic growth. **(4 marks)**

QUESTION THREE (20 Marks)

- Differentiate between Economic growth and Economic development **(4 marks)**
- Regional development disparities are common in less developed countries
 - Identify and explain briefly any **three** key factors contributing to these disparities. **(6 marks)**
 - Analyze any **two** effects of these imbalances on economic growth and social stability. **(4 marks)**
 - Recommend **three** policy measures that governments in less developed countries can adopt to mitigate these imbalances. **(6 marks)**

QUESTION FOUR (20 Marks)

- Discuss **four** factors that may hinder the effective implementation of fiscal policy in developing countries. **(8 marks)**

- (b) Discuss how trade policies can lead to trade wars and their potential impacts on global economic stability. (4 marks)
- (c) Define the balance of payments and explain its two main components. (4 marks)
- (d) Explain **four** negative effects of a contractionary fiscal policy in an economy. (4 marks)

QUESTION FIVE (20 Marks)

- (a) Argue the case for and against interest rate decontrol. (12 marks)
- (b) Give **four** distinctions between quantity theory of money and Keynesian liquidity preference theory (8 marks)