



"Investing in Africa's Future"

**COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND
GOVERNANCE**

MEC 102 ECONOMICS PRICIPLES 2

END OF FIRST SEMESTER EXAMINATIONS

MAY 2017

LECTURER: T MASESE

DURATION: 3 HRS

INSTRUCTIONS

Answer **ALL** questions in this paper

Total possible mark is 100%

Start **each** question on a new page in your answer Booklet.

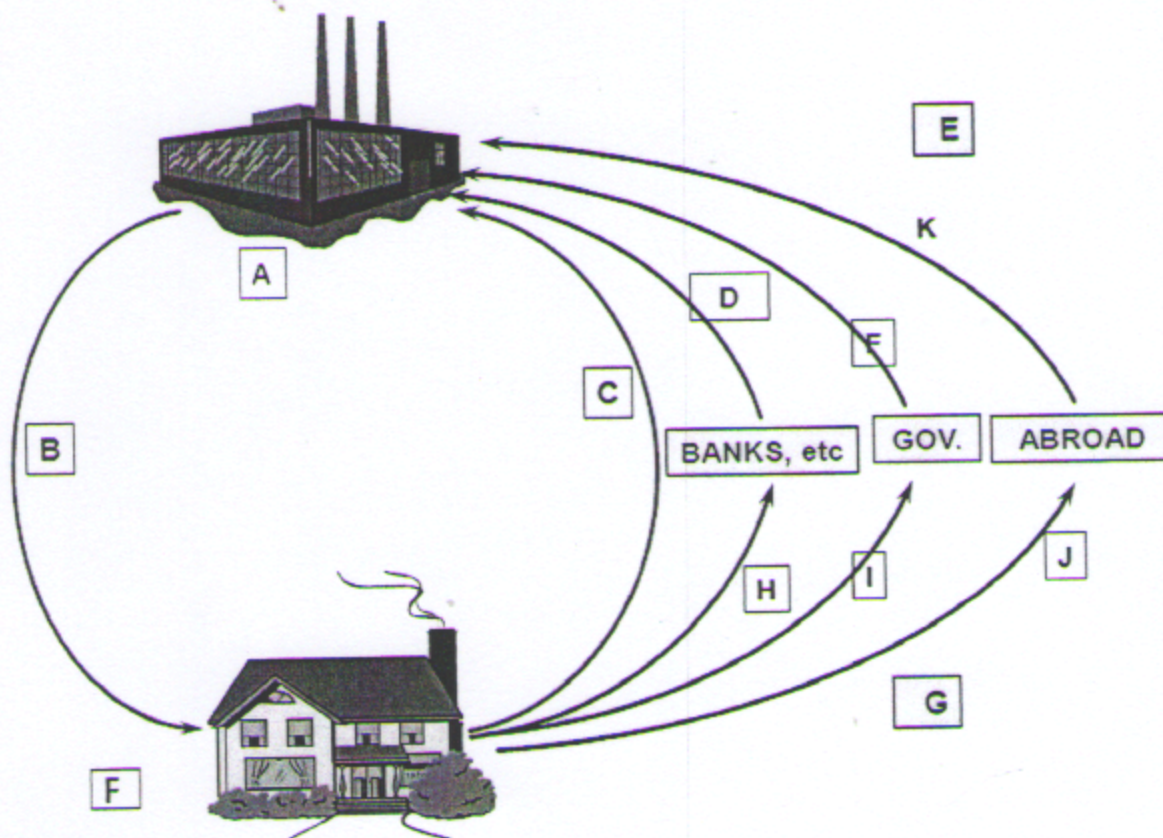
The marks allocated to **each** question are shown at the end of the section.

Show all your workings.

Credit will be awarded for logical, systematic and neat presentations.

Question One

- Explain what is meant by macroeconomics clearly outlining its concerns. What are the major components of the macro-economy (6 marks)
- What does the following diagram represent? Write down what is represented by each alphabet letter in the diagram (12 marks)



- Some countries have very high GDPs yet their people seem to be very poor. Briefly outline any six limitations of using GDP concept as a way of measuring the welfare of people in a country (6 marks)
- Briefly explain the two specific policy channels the government can use to affect the macro economy (3 marks)

Question Two

- Suppose the following information reflects the closed economy of Portugal (in millions of dollars). The consumption function is such that $C = 300 + 0.75(Y_d)$, Investment is fixed at \$450m, the current runs a positive balance of trade of \$60m

with the country currently importing \$50m worth of goods and the government has a balanced budget, where both government purchases and taxes equal \$1,000m. The country's imports are \$60m and the country runs a negative balance of trade of \$10m

These equations describe the economy:

$Y_d = Y - T$ where Disposable income is total income less taxes.]

$AE = C + I + G + NX$ where Aggregate demand is the total of consumption, investment, government purchases, and net exports.]

$AE = Y$ [In equilibrium, total spending matches total income or total output]

- Derive the marginal propensity to save and the saving function for this economy as well as the expenditure and tax multipliers for this economy (6 marks)
- Describe the steps you would take to calculate the equilibrium level of GDP for this economy and calculate it (Y^e) (4 marks)
- Calculate the level of consumption, savings, exports and disposable income when economy is in equilibrium (5 marks)
- Suppose the government chooses to increase its purchases by \$50m. Describe the steps you would take to determine the new equilibrium level of output. What is the change in equilibrium income (4 marks)
- Assume the potential level of output is \$5,000, according to the Keynesian philosophy what actions should the government take? Describe how you arrived at your conclusions. (5 marks)

Question Three

a. FBC Bank has the following balance sheet as at 31 December 2014

Assets		Liabilities	
	\$		\$
Cash Reserves	110 000	Current Account Deposits	100 000
Property and Buildings	240000	Owners' Equity	250000
TOTAL	350 000	TOTAL	350000

If the required reserve ratio is 10%, calculate the excess the excess reserves for FBC Bank. What is the money multiplier for this economy? If FBC was part of multiple bank system in the country and does not keep any excess reserves, what is the maximum

amount of new current account deposits that can be created by the banking system (6 marks?)

- b. Briefly explain the quantitative and qualitative monetary policy tools (7 marks)
- c. Outline and explain any FIVE functions of the Central Bank (5 marks)
- d. Why are changes in inventories included as part of investment spending? Suppose inventories declined by \$1 billion during 2016. How would this affect the size of gross private domestic investment and gross domestic product in 2016? Explain. (

Question Four

- a. Suppose that creating a bicycle from scratch requires five different steps from five different firms. Firm A mines the raw metal from the earth and sells it to the metal refinery for \$90 and Firm B, the metal refinery, processes the metal it receives, purifying it and turning it into a metal that can be used for manufacturing purposes. Firm B sells the now processed metal to Firm C for \$150. Firm C turns the metal into a functioning bike before selling it to Firm D for \$400. Firm D distributes the bicycles to retailers at \$500 apiece. Firm E, the bike shop, then retails the bicycle to a consumer for \$700. Calculate the value added at each stage of this process and give the amount that will be included in the calculation of GDP (5 marks)
- b. Briefly explain the 3 methods of calculating a country's GDP? (3 marks)
- c. Briefly explain the three main determinants of money demand and illustrate with the arrow notation the effect of an expansionary fiscal policy on interest rates of the Central Bank does not accommodate the increase in money demand (5 marks)
- d. GDP is a reasonably accurate and highly useful measure of how well or how poorly the economy is performing. But it has several shortcomings as a measure of both total output and well-being (total utility). Explain (10 marks)
- e. What are the basic determinants of investment? Explain the relationship between the real interest rate and the level of investment. Why is investment spending unstable? (6 marks)
- f. Suppose that the linear equation for consumption in a hypothetical economy is $C = 40 + 0.8Y$. Also suppose that income (Y) is \$400. Determine (a) the marginal propensity to consume, (b) the marginal propensity to save, (c) the level of

consumption, (*d*) the average propensity to consume, (*e*) the level of saving, and (*f*) the average propensity to save. (5 marks)

END OF PAPER