232/1929

INSTRUCTION: *Attempt four (4) Questions in all. Questions 1 and 4 are Compulsory.*

Question 1: Answer **True, False or Ambiguous** and support your choice with reason(s) *not more than two lines.*

a. There are 2 countries in the world, Home and Foreign; foreign's interest rate is fixed, and the expected future exchange rate is exogenously fixed. Given these conditions, a rise in the Home interest rate today will lead to a stronger Home currency today (i.e. an appreciation of the Home currency.)

b. There is strong empirical evidence that consumers spend income from tax cuts, largely ignoring potentially large future deficits.

c. The effect of a fiscal expansion on the equilibrium Y, C, G, I, X, M, NX, r and E, given fixed prices (midterm) is $\uparrow Y, \uparrow C, \uparrow G, ?I, \downarrow X, \uparrow M, \downarrow NX, \uparrow r, \downarrow E$.

d. The average propensity to consume (APC) is equal to the change in consumer spending divided by the change in income.

e. According to the Life Cycle model, a relaxation of borrowing restrictions (i.e. when it becomes easier to borrow money) should have no effect on consumption smoothing.

f. The growth rate of investment is as volatile as the growth rate of consumption.

g. All else equal, Firms' optimal levels of capital are higher when the interest rate is higher.

h. If the money supply does not grow as fast as the price level, output will tend to fall and interest rates tend to will rise.

i. A country with fixed exchange rates and permanently high inflation relative to other countries will have its consumers' purchasing power deteriorated.

j. If National Assembly passes new labour laws giving more bargaining power to the firm, the natural rate of unemployment will increase. **15 marks**

Question 2

a. Suppose that autonomous consumption is 400 and the marginal propensity to consume is 0.60. Write an algebraic expression for the consumption equation.

b. Sketch a graph of this consumption curve that corresponds to the consumption equation above. Include the income line in your drawing and label autonomous consumption.

c. Calculate the level of income at which income is equal to consumption, that is, where the consumption curve intersects the income line.

d. Using the consumption equation (a) above, what is the MPS for the corresponding saving curve?

e. At what level of income will saving be zero? (Hint: What is the level of income where consumption is equal to income?) Use this point and the MPS to sketch the saving curve. **17½ marks**

Question 3

a. Suppose that Keynes's absolute income hypothesis had been shown to be correct. What would happen to consumption spending as national income increased in a country? How would producers respond to this change in consumption spending and what would be the likely impact on GDP growth over time?

b. Suppose that your boss gives you a year-end bonus and you count it as transitory income. Suppose that this happens three years in a row. Would you continue to count this income as transitory? Why or why not?

c. Why does the relative income hypothesis predict that the MPC will be constant as national income increases?

d. What is the difference between a shift in the consumption curve and a movement along the consumption curve?

17½ marks

Question 4

a. Suppose a production function is given as $Q = 45L - 5L^2$. Find the MPP_L function and derive MPP_L curve. Derive labour demand curve assuming price (P) = N2.

b. Suppose Amina's life expectancy (N) is 80years, the retirement age (R) is 60years and age at start of working life (B) is 20years. If her annual income is N225000, calculate her (i) Lifetime income (ii) Lifetime consumption (iii) Lifetime saving (iv) Working Lifetime income.

c. Suppose a company is considering an investment of N50 million. The market rate of interest is 10 percent and anticipated marginal efficiency of investment is 12 percent. How will the company react to each of the following changes in the conditions?

(i). Market rate of interest increases to 12 percent.

(ii). Marginal Efficiency of Capital (MEC) increase to 14 percent.

(iii). Cost of capital increases from N50 million to N60 million.

(iv). MEC decreases to 9 percent due to increase in operational cost.

20 marks

Question 5

a. State and explain the macroeconomic goals and their respective measures.

b. Distinguish between economic and non-economic production in national income accounting. Why is non-economic production excluded from national income estimates?

c. Explain the difference between final and intermediate products. How does the inclusion of intermediates affect the measure of national income?

d. What is meant by GDP deflator? What purpose does it serve in national income analysis?

17½ marks

Question 6

a. From the following data, compute (i) real GNP, (ii) GNP deflator, (iii) implicit GNP deflator, and (iv) rate of inflation

Year	Nominal GNP (in million Naira)	Wholesale Price (1993-94 = 100)
2002 – 03	2248614	166.8
2003 – 04	2531168	175.9

b. Explain briefly the postulates made by the classical economists. Do you agree with the postulates of the classical economists. Give reasons for your answer.

c. Explain and illustrate graphically the classical theory of employment and output determination.

d. State the assumptions of income determination in a simple economy model.

17½ marks

GOOD LUCK!