

- iv) Illustrate (iii) above using a well labelled diagram of the Keynesian cross. (5 marks)
- v) Briefly explain the two types of exchange rate regimes. (4 marks)
- b) Using relevant examples, explain the following concepts as used in the circular flow of income in an open economy (6 marks)
- a) Injections
- b) Withdrawals
- c) By use of a graph, explain the meaning of ratchet effect and paradox of thrift (6 marks)

QUESTION TWO (20 MARKS)

- a) Differentiate between narrow money (M_1) and broad money (M_2). (4 marks)
- b) Why do people hold money when they can earn interest by lending it to others or by buying interest yielding bonds? (6 marks)
- c) Through which instruments does the Central Bank of Kenya control money supply? (6 marks)
- d) Graphically derive the IS curve (4 marks)

QUESTION THREE (20 MARKS)

- a) The following data relate to an emerging African country.

Item	Value ('000) KSHS
GNP	8,000,000
Depreciation	100,000
Indirect Business Taxes	80,000
Gross Investment	400,000
Total population	30,000
Consumption	10,000
Personal Income Taxes	800
Excise duty	80
Personal Income	89,000
Net factor incomes from abroad	200,000