



MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FIRST YEAR FIRST SEMESTER EXAMINATION FOR DIPLOMA IN EDUCATION

EAE 0204: MONEY AND BANKING

DATE:2/12/2019

TIME: 11.00-1.00 PM

INSTRUCTIONS:

1. Answer question one and any other two questions
2. Question one is compulsory and carries (30 marks)
3. All other questions carry (20 marks each)

QUESTION ONE (30 MARKS)

- a) Illustrate and explain the impacts of a central bank reduction of its bank rate when an economy has a “liquidity trap” demand for money section (10 marks)
- b) Explain the properties that any commodity should possess in order to serve as a medium of exchange (10 marks)
- c) Assume a situation where central bank directs commercial banks to keep 15% of total deposits they receive as reserves while the public desires to hold 18% of the money received, determine the total money that could be circulated from an initial deposit of 650 billion shillings. Out of this, calculate how much will be in cheques and cash (5 marks)
- d) Explain the core functions of money (5 marks)
- e) Explain the limitations of the process of money creation (10 marks)

QUESTION TWO (20 MARKS)

- a) Clearly discuss the critics by Keynes on the fisher’s quantity theory of money demand (10 marks)
- b) Distinguish between a bank run and a bank panic (4 marks)
- c) Outline techniques of preventing or mitigating the effects of bank run (6 marks)

QUESTION THREE (20 MARKS)

- a) Explain the limitations of the process of money creation (10 marks)
- b) Assume central bank of an economy has put the required reserve ratio (r) as 10%. Assume that the banking system has excess reserves equal to \$4 billion. Further, the currency in circulation equals to \$ 450 billion, and the total amount of checkable deposits equals \$ 900 billion. Based on these numbers, calculate;
- i) Required reserves hold by the banking system (2 marks)
 - ii) Total reserves held by the banking system (2 marks)
 - iii) Monetary base (2 marks)
 - iv) Total money supply (M1) (2 marks)
- c) The money multiplier (2 marks)

QUESTION FOUR (20 MARKS)

- a) Discussion the importance of non-bank financial institutions in economic growth and development process of a county (10 marks)
- b)
 - i) Briefly explain the concept of money “illusions” (5 marks)
 - ii) Explain the relationship between money supply and inflation (5 marks)

QUESTION FIVE (20 MARKS)

- a) Discuss the role of central bank in a country’s economy (10 marks)
- b) How has demonetization affected the way business are done in the country (10 marks)