MACHAKOS UNIVERSITY

University Examinations for 2017/2018

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF COMMERCE

BACHELOR OF ECONOMICS

BACHELOR OF ARTS

EAE 310: ECONOMICS OF MONEY AND BANKING

DATE: 14/12/2017 **TIME: 8:30 – 10:30 AM**

INSTRUCTIONS

Answer question one and any other two questions. Question one carries 30 marks and the other questions carry 20 marks each.

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Clearly explain the Keynesian theory of money demand and discuss why monetary policy is ineffective along the liquidity trap (8 marks)

b) Suppose you have the following information about the banking system in Kenya. The money supply is \$6,000,000, currency held by the public is \$2,000,000 and the reserve deposit ratio is 0.25.

Calculate

1. Deposits (2 marks)
2. Bank reserves (2 marks)
3. The monetary base (2 marks)
4. The money multiplier (2 marks)

c) Differentiate using relevant equations and diagrams (where applicable) between contractionary and expansionary monetary and fiscal policies (10 marks)

d) Is foreign currency a store of value or a medium of exchange? Explain your answer. (4 marks)

QUESTION TWO (20 MARKS)

a) Differentiate between commercial banks and non-bank financial intermediaries (5 marks)

b) Using the classical quantity theory of money, explain the determinants of money demand. Demonstrate also using the equation of exchange how they cause of inflation. (7 marks)

c) The central bank has been blamed for the failure of many financial institutions. Discuss this statement. (8 marks)

QUESTION THREE (20 MARKS)

a) What is credit creation? Discuss the limitations of the process of credit creation (10 marks)

b) Currently Kenya's economy has been experiencing persistent rise in the prices of various commodities. The most current that has hit the citizens is the sharp rise in the prices of basic commodities such as maize flour, milk and sugar. This has led to the introduction of subsidies to at least lower the price of maize flour. In the context of Kenya, explain what measures the government, through the central bank can undertake to correct the situation. (10 marks)

QUESTION FOUR (20 MARKS)

a) When you compare commercial banks in developing countries and those in developed countries, which ones perform better? Give reasons for your answer. (10 marks)

b) Explain the limitations of monetary policies in developing countries (10 marks)

QUESTION FIVE (20 MARKS)

a) Assuming that an individual is paid KShs 24,000 salary at the 1st day of every month. Supposing that he gets half of it cashed and saves the rest in a savings account earning an interest of 10%. Given that the brokerage fee is KShs 50 per transaction, calculate the total cost incurred by the individual as well as the optimal cash holdings that minimize the transaction costs. Show all you workings. (6 marks)

b) Explain the functions of money and explain how inflation affects each function. (4 marks)

c) Discuss the evolution of money stating the limitations of each stage (10 marks)