MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FOURTH YEAR SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

EAE 401: MONETARY THEORY AND POLICY

DATE: 24/7/2019 **TIME: 2:00 – 4:00 PM**

INSTRUCTIONS:

Answer Question One and Any Other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) State and briefly explain with the aid of a diagram two factors or events that can cause shifts in aggregate demand. (5 marks)

b) Explain why aggregate supply curve is vertical in long-run (3 marks)

c) Suppose suddenly firms experience an increase in the costs of production as a result of increase in price of petroleum and electricity bills. As result of this the aggregate supply curve shifts to the left. Illustrate this shifting in an aggregate demand (AD) – aggregate supply (AS). Discuss the effects of this shifting on price level and income or output. (10 marks)

d) Using IS-LM model, explain the effects of expansionary monetary, which involves the Central Bank increasing money supply, on interest rate and income/output. (6 marks)

e) State any five functions of money. (5 marks)

QUESTION TWO (20 MARKS)

a) State and clearly explain three main objectives of monetary policy undertaken by Central Bank of Kenya. (9 marks)

b) Discuss the main idea on the Keynesian demand for money stating clearly three motives for holding money. (11 marks)

QUESTION THREE (20 MARKS)

a) Differentiated between expansionary monetary policy and contractionary monetary policy . (4 marks)

b) Differentiate between:-

i) Expansionary monetary policy and contractionary monetary policy.

ii) Expansionary fiscal policy and contractionary fiscal policy. (4 marks)

c) With the aid of diagrams explain the effects of expansionary monetary policy and contractionary monetary policy (IS-LM framework) (12 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the concept of the liquidity preference as put forward by Keynes. (5 marks)

b) Give a graphical representation of the supply aggregate supply shift and clearly discuss any four determinants of the short-run aggregate supply shift in the short run. (15 marks)

QUESTION FIVE (20 MARKS)

a) Discuss any five roles of the US Federal Reserve Bank. (10 marks)

b) State the main advantages of using open market authorities to influence short-term interest rates. (4 marks)

c) Explain the following terms as used in the model of money supply

i) The monetary base

ii) The reserve-deposit ratio

iii) The currency-deposit ratio (6 marks)