MACHAKOS UNIVERSITY

University Examinations for 2016/2017 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARMENT OF ECONOMICS

THIRD YEAR FIRST SEMESTER EXAMINATION FOR BACHELOR OF SCIENCE IN AGRIBUSINESS

EAE 310: ECONOMICS OF MONEY AND BANKING

DATE: 25/7/2017 **TIME: 11:00 – 1:00 PM**

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) Distinguish between the following set of terms (8 marks)
   i) Time deposits and demand deposits
   ii) Commodity money and fiat money
   iii) Money multiplier and deposit multiplier
   iv) Expansionary monetary policy and contractionary monetary policy

b) Clearly explain the Keynesian theory of money demand and discuss why monetary policy is ineffective along the liquidity trap (6 marks)

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

d) 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)

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 the cause of inflation. (5 marks)

c) Currently Kenya's economy has been experiencing persistent rises 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 salvage the situation. (10 marks)

QUESTION THREE (20 MARKS)

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

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

QUESTION FOUR (20 MARKS)

a) Explain why commercial banks in developing countries perform poorly compared to those in developed countries (10 marks)

b) Explain the limitations of monetary policy 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 your workings. (8 marks)

b) Explain the functions of money and discuss how inflation affects the functions of money (8 marks)

c) What does it mean to say that foreign currency is a store of value but not a medium of exchange? (4 marks)