MACHAKOS UNIVERSITY

University Examinations for 2016/2017

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SECOND SEMESTER EXAMINATION FOR DEGREE IN

BACHELOR OF COMMERCE

EAE 401: MONETARY THEORY AND POLICY

DATE: 2/6/2017 **TIME: 11:00 – 1:00 PM**

INSTRUCTIONS:

Answer Question ONE and Any Other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Distinguish between the following pairs of concepts as used in monetary economics

i. Fixed Exchange rate and floating exchange rate

ii. Demand-pull inflation and Cost-push inflation

iii. Central bank independence and Balance of payments crisis

iv. Money multiplier and deposit multiplier

v. Expansionary monetary policy and contractionary monetary policy

b) Distinguish between expansionary monetary policy under a fixed exchange rate regime and a floating exchange rate regime (12 marks)

c) 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

i. Deposits (2 marks)

ii. Bank reserves (2 marks)

iii. The monetary base (2 marks)

iv. The money multiplier (2 marks)

QUESTION TWO (20 MARKS)

a) Explain the concept of money demand and discuss the Friedman's theory of money demand (8 marks)

b) Derive the complex money multiplier and clearly show the factors that affect the size of the multiplier (8 marks)

c) Explain the relationship between foreign exchange intervention and money supply (4 marks)

QUESTION THREE (20 MARKS)

a) The monetarists and the Keynesians had various opposing views on the management of economic activities. Discuss the Keynesian critique of the monetarist's evidence (8 marks)

b) Explain any six monetary transmission mechanisms in the economy clearly showing the transmission channels (12 marks)

QUESTION FOUR (20 MARKS)

a) The monetarists describe inflation as a monetary phenomenon. Inflation is currently a policy issue in the Kenyan economy as well as some other economies. In the light of this statement, explain the monetary measures that can be used to curb inflation. (8 marks)

b) Developing countries experience some problems within their systems that affect the effectiveness of several macroeconomic policies. Explain, using relevant examples, the problems/challenges faced in the implementation of monetary policy in these countries. (8 marks)

c) Briefly explain the Tobin's portfolio approach to money demand (4 marks)

QUESTION FIVE (20 MARKS)

a) Explain the relationship between the Central bank independence and macroeconomic performance (4 marks)

b) Clearly explain the determinants of money supply showing the weaknesses of each (8 marks)

c) Explain the various monetary policy tools and clearly show how each is used to achieve the monetary policy goals (8 marks)