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: **TIME:**

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) Discuss any five roles of the US Federal Reserve Bank (8 marks)

b) State the main advantages of using open market authorities to influence short-term interest rates (2 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)

d) Graphically explain the shift in the aggregate demand curve .Discuss any two factors that cause the shift in the demand curve (9 marks)

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

f) Explain what you mean by the term monetary policy? (1 mark)

QUESTION TWO (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 THREE

a) 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)

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

c) What is money multiplier? Derive the expression for the complex money multiplier (9 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the main idea of the Keynesian Demand for Money stating clearly three motives for holding money. (8 marks)

b) Discuss the consequential economic impacts of high and rising rates of interest (6 marks)

c) Explain how money stock and money velocity causes inflation. (6 marks)

QUESTION FIVE (20 MARKS)

a) Explain how four instruments of monetary policy can be used to control and regulate money supply in the economy as applied by the central bank of a given country. (8 marks)

b) Graphically explain the Cambridge Cash Balance Approach of money demand giving its strengths and weaknesses. (12 marks)