MACHAKOS UNIVERSITY

University Examinations for 2016/2017

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FOURTH YEAR SECOND SEMESTER EXAMINATION FOR DEGREE IN BACHELOR OF EDUCATION

EAE 310: ECONOMICS OF MONEY AND BANKING

DATE: 30/5/2017 **TIME: 2:00 – 4:00 PM**

INSTRUCTIONS:

Answer question ONE and any other two question

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Using the classical quantity theory of money, explain the determinants of money demand. Demonstrate also using the equation of exchange the cause of inflation. (6 marks)

b) Distinguish between the following set of terms (8 marks)

i. Time deposits and demand deposits

ii. Commodity money and fiat money

iii. Selective credit control and liquidity ratio

iv. Bank run and deposit insurance

c) Derive the real world money multiplier. Given that

C = currency held by the public = $400 billion

D = checking deposits = $800 billion

ER = excess reserves = $0.8 billion

RRR= required reserve ratio is 10%

Compute the size of the multiplier and interpret it (6 marks)

d) Using relevant diagrams, distinguish between the Keynesian and the Classical theory of interest rates clearly highlighting the criticisms of each (10 marks)

QUESTION TWO (20 MARKS)

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

b) Explain the various monetary policy tools and clearly highlight the limitations of each in achieving the desired macroeconomic goals (10 marks)

c) Distinguish between M1, M2 and M3 definitions of money and show which of them is generally used to measure money supply in the economy (5 marks)

QUESTION THREE (20 MARKS)

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

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

QUESTION FOUR (20 MARKS)

a) Clearly discuss how the central bank has led to the failure of many Non-bank Financial Intermediaries (NBFI'S) in Kenya (10 marks)

b) How can the government through the central bank respond to a depression in the economy? (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. (10 marks)

b) Explain Keynes theory of money demand and clearly explain why monetary policy is ineffective along the liquidity trap (10 marks)