MACHAKOS UNIVERSITY COLLEGE

(A Constituent College of Kenyatta University)
University Examinations for 2015/2016

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FIRST SEMESTER EXAMINATION FOR DEGREE IN

BACHELOR OF SCIENCE (AGRIBUSINESS)

BACHELOR OF EDUCATION

EAE 310: ECONOMICS OF MONEY AND BANKING

Date: 8/8/2016 **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)

a) Clearly distinguish between the following set of terms within the framework of money (8 marks)

i) Money demand and money supply

ii) High powered money and money multiplier

iii) Bank rate policy and open market operations

iv) Velocity of money and liquidity trap

b) 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 (7 marks)

c) Define monetary policy and explain with the aid of relevant examples its objectives (7 marks)

d) Explain using relevant examples Friedman's theory of money demand. (8 marks)

QUESTION TWO

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) Differentiate using the relevant equations and diagrams (where applicable) between contractionary and expansionary monetary policy, and contractionary and expansionary fiscal policy. (10 marks)

QUESTION THREE

a) Explain Keynes theory of money demand and clearly highlight the weaknesses of the liquidity preference theory (10 marks)

b) Using Kenya as an example, discuss the limitations of monetary policy in developing countries (8 marks)

c) What do you understand by the term credit creation. (2 marks)

QUESTION FOUR

a) Compare and contrast between the functions of commercial banks and the central banks (8 marks)

b) What is a policy mix and how does it work in the economy. (5 marks)

c) Monetary policy is used to achieve some economic objectives. However, sometimes the attainment of one objective hinders the achievement of the other. In light of the above statement, explain using relevant examples, the conflicting objectives of monetary policy. (7 marks)

QUESTION FIVE

a) Clearly discuss the determinants of money supply highlighting the weaknesses of each (10 marks)

b) Compare and contrast between Tobin's portfolio approach and Baumol's inventory approach to money demand clearly highlighting the determinants of money demand in each**.** (10 marks)