



# **MAASAI MARA UNIVERSITY**

**REGULAR UNIVERSITY EXAMINATIONS  
2020/2021 ACADEMIC YEAR  
SECOND YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS & ECONOMICS  
BSC. ECONOMICS  
BSC. FINANCIAL ECONOMICS  
BSC. ECONOMICS AND STATISTICS**

**COURSE CODE: ECO 2205**

**COURSE TITLE: ECONOMICS OF MONEY AND BANKING**

**DATE: 7<sup>TH</sup> OCTOBER, 2021**

**TIME: 1100 – 1300HRS**

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**INSTRUCTIONS TO CANDIDATES**

Answer Question **ONE** and any other **THREE** questions

*This paper consists of **THREE** printed pages. Please turn over.*

## QUESTION ONE

a) Consider a closed economy ( $NX = 0$ ) and assume the following functions

$$C = a - mpc \times (Y - TR + TA)$$

$$I = I + bi_r$$

$$G = G$$

where  $I$  is autonomous investment expenditure;

$i_r$  is the real interest rate,

$b > 0$ ;

$TR$  denotes transfers, which are assumed to be exogenous; and  $TA$  denotes taxes, which are given by  $TA = t \times Y$ , where  $t$  is the tax rate on income.

- i. Derive the aggregate demand function. (4 Marks)
  - ii. Derive the equation for the IS curve. (5 Marks)
  - iii. What is the slope of the IS curve? (3 Marks)
  - iv. Discuss how the slope of the IS curve is affected by  $b$ ,  $t$ , and  $mpc$ . (3 Marks)
- b) The money supply is determined jointly by the behavior of non-banking public, central bank authority and commercial banking system. Discuss (10 marks)

## QUESTION TWO

- a) Discuss the features of a well developed money market (8 Marks)
- b) Discuss the three Keynesian Motives for holding Money (7 Marks)

## QUESTION THREE

Using appropriate illustrations, explain how both interest rates and aggregate output are determined when the price level is fixed. (15 Marks)

#### QUESTION FOUR

- a) Discuss the role of central bank in economic development of a country such as Kenya (10 marks)
- b) Explain the process of credit creation in banks (5Marks)

#### QUESTION FIVE

Consider the following money demand function (in real terms)

$$M/P = kY + bi$$

where  $k$  is the income elasticity and  $b$  is the (nominal) interest rate elasticity of real money balances.

Assume that  $k > 0$  and that  $b > 0$ .

Further assume that the quantity of nominal money balances is fixed by the Central Bank at  $M$  and that the price level,  $P$ , is also fixed at  $P$ .

- a. Derive the equation for the LM curve. (6 Marks)
- b. What is the slope of the LM curve? (3 Marks)
- c. Discuss how the slope of the LM curve is affected by  $k$  and  $b$ . (6 Marks)

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