MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS
2018/2019 ACADEMIC YEAR

BACHELOR OF ARTS IN ECONOMICS
SECOND YEAR SECOND SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF SCIENCE IN (ECONOMICS,FINANCIAL ECONOMICS, ECONOMICS AND STATISTICS AND AGRICULTURAL ECONOMICS AND RESOURCE MANAGEMENT).

COURSE CODE: ECO 2205
COURSE TITLE: ECONOMICS OF MONEY AND BANKING

DATE: 29/04/2019 **TIME: 1430 – 1630 HRS**

INSTRUCTIONS TO CANDIDATES

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

QUESTION ONE

a) Explain good characteristics of commodity money **(5Marks)**

b) The income elasticity of money demand is 2/3 and the interest elasticity of money demand is -0.1.real income is expected to grow by 4.5% over the next year, and the real interest rate is expected to remain constant over the next year. The rate of inflation has been zero forseveral years.

  i. If the central bank wants zero inflation over the next year, find what growth rate of the nominal money supply it should choose**.** **(3Marks)**

  ii. Calculate how much velocity will change over the next year if the central bank follows thepolicy that achieves zero inflation**.** **(4Marks)**

c) i. Define the concept money **(2Marks)**

ii.How does economist's uses of this differ from its everyday meaning? **(3Marks)**

d) Differentiate between barter transaction and money transactions systems **(5Marks)**

e) Discuss the role of velocity in the quantity theory of money **(3Marks)**

QUESTION TWO

a) Explain the objectives of money in less developed economies. Use examples and illustrations. (**4Marks)**

b) Explain factors responsible for banking crises in third world economies **(4Marks)**

c) Explain the neutrality of money concept **(2Marks)**

d) Discuss three major policy instruments adopted by central bank to control money supply

(3Marks)

e) Discuss the components of money
(2Marks)

QUESTION THREE

a) Explain the evolution of money policy in developing economies
(3Marks)

b) Use examples and illustrations, explain the process of credit creation in banks
(**5Marks)**

c) Discuss the micro-economics variables that affect the aggregate demand for money. **(4Marks)**

d) Explain the relationshipbetween the price level and the nominal money supply when all markets are in equilibrium
(**3Marks)**

QUESTION FOUR

a) Discuss how actions of the public and banks can cause the money multiplier to rise or fall.

(3Marks)

b) Explain the role of financial intermediaries in less developed economies.
(4Marks)

c) When the real interest rate increases, banks have an incentive to lend a greater portion of their deposits, which reduces reserve-deposit ratio.in particular, suppose that

res=0.8 - 4r

Where res is the reserve –deposit and r is the real interest rate. The currency-deposit ratio is 0.5.the price level is fixed at 1.0 and the monetary base is 60.the real quantity of money demanded is

L(Y,i)=0.6Y – 15i,

Where Y is the real output and i is the nominal interest rates. Assume that expected inflation is zero so that the nominal interest rate and real interest rate are equal.

If r=i=0.20

Find:

i. The reserve-deposit ratio. **(2Marks)**

ii. The money multiplier **(2Marks)**

iii. The money supply **(2Marks)**

iv. What real output Y clears the asset market. **(2Marks)**

QUESTION FIVE

A. Explain how interest rates are determined under the following approaches
   I. Classical **(3Marks)**
   II. Monetarism **(3Marks)**

B. Explain the following concepts as used in economics of money and banking
   i. Monetary transmission mechanism **(1Mark)**
   ii. Intermediate targets **(1Mark)**
   iii. Fractional reserve banking **(1Mark)**
   iv. High powered money **(2Marks)**
   v. Liquidity trap **(1Mark)**

C. Explain three function of money. **(3Marks)**

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