MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS 2017/2018 ACADEMIC YEAR
FOURTH YEAR SECOND SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF ARTS (ECONOMICS)

COURSE CODE: ECO 421
COURSE TITLE: MONETARY THEORY & POLICY

DATE: 24TH APRIL, 2018   TIME: 0830 – 1030HRS

INSTRUCTIONS TO CANDIDATES
Answer Question **ONE** and any other **THREE** questions

QUESTION ONE

a) Explain the relationship between the price level and nominal money supply when all markets are in equilibrium. **(5 Mrks)**

b) Discuss the relationship between inflation and nominal money supply. **(4 Mrks)**

c) Discuss the objectives of monetary policy in the economy. **(5 Mrks)**

d) "A government deficit is bad because it leads to rapid monetary growth". Explain why this statement is wrong. **(5 Mrks)**

e) Discuss the role of monetary policy in the following economies.
      i) Closed economy **(3Mrks)**
      ii) Open economy **(3 Mrks)**

QUESTION TWO

a) Define M_1 and M_2. **(3 mks)**

b) Discuss that factors that determine demand for money. Use the following approaches.
    i)   Keynesian approach. **(4 mks)**

    ii)   Classical approach **(4 mks)**

c) Explain the modern theory of money. **(4 mks)**

QUESTION THREE

Assume that nominal GDP was Ksh 1000 billion in year 0 while the GDP deflator was 1 in year 0.

Furthermore, the money supply in years 0, 1, 2, 3 and 4 was Ksh 50 billion, Ksh 52 billion, Ksh 55 billion, Ksh 58 billion and Ksh 60 billion.

    i)   Find the level of nominal output in years 1, 2, 3, and 4 according to the strict quantity theory of money. **(2 mks)**

    ii)   If there was no growth in potential output and the level of the money supply was following a preannounced path, what would the level of real GDP be according to new classical macroeconomics? **(4 mks)**

a) Explain the role and functions of Central bank in the following economies.
   i)   Developing countries   **(3 mks)**
   ii) Developed countries   **(3 mks)**

QUESTION FOUR
a) Explain the following concepts as used in monetary theory and policy.

   i)   The exchange fund account   **(1mks)**
   ii)   Intermediate targets   **(1mks)**
   iii)   Bank runs   **(1mks)**
   iv)   Fractional reserve banking   **(1mks)**
   v)   Money multiplier   **(1mks)**

b) Explain how the supply of money could be expanded or reduced in an economy in which all money is in the form of currency.   **(5 mks)**

c) Discuss the macro-economic variables that affect the aggregate demand for money.

                                                                (5 mks)

QUESTION FIVE
a) i) Describe the differences between Keynesian and monetarist monetary transmission mechanism.   **(4 mks)**

   ii) In what ways does Keynesian fiscal policy short-circuit the difficulties they perceive in transforming new money that inter new spending?
                                                                (3 mks)

b) Suppose a rule of 3% annual monetary growth were imposed. Explain how long should policy makers doggedly follow such policy if inflation soaked to more than 20% or unemployment hovered around 15%.
                                                                (4 mks)

c) Use a diagram to explain domestic money market equilibrium.
                                                                (4mks)

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