



MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS

EAE 310: ECONOMICS OF MONEY AND BANKING

DATE: 22/1/2021

TIME: 8.30-10.30 AM

INSTRUCTIONS:

- (i) Answer question one (Compulsory) and any other two questions
- (ii) Do not write on the question paper
- (iii) Show your working clearly

QUESTION ONE (COMPULSORY) (30 MARKS)

- a) Explain the following concepts
 - i. Eurobond (2 marks)
 - ii. Financial markets (2 marks)
 - iii. Financial Intermediaries (2 marks)
- b) Explain the factors that affect money demand as explained by Friedman (8 marks)
- c) Explain four measures of money supply (8 marks)
- d) Suppose you have the following information about the banking system in Kenya. The money supply is \$6,000,000, currency held by the public is \$2,000,000 and the reserve deposit ratio is 0.25.
 - i. Deposits (2 marks)
 - ii. Bank reserves (2 marks)
 - iii. The monetary base (2 marks)
 - iv. The money multiplier (2 marks)

QUESTION TWO (20 MARKS)

- a) Clearly explain the Keynesian theory of money demand and discuss why monetary policy is ineffective along the liquidity trap (10 marks)
- b) Explain the determinants of money supply using the money multiplier theory (10 marks)

QUESTION THREE (20 MARKS)

- a) Explain how tools of monetary policy regulates money supply in an economy (6 marks)
- b) Explain role of financial intermediaries in Kenya. (6 marks)
- c) Explain the Friedman theory of money demand and state eight determinants of money demand as per this theory. (8 marks)

QUESTION FOUR (20 MARKS)

- a) Compare commercial banks in developing countries and those in developed countries. Which ones that perform better? Give reasons for your answer. (8 marks)
- b) Given that a given economy is described by the following:
- Currency held by the public = \$400 billion
 - Checking deposits = \$800 billion
 - Excess reserves = \$0.8 billion
 - M1 (narrowest measure of money supply) = C + D = \$1200 billion
- Calculate the real world money multiplier (4 marks)
- c) Explain the limitations of monetary policy in developing countries (8 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. Show your workings. (8 marks)
- b) Explain role of central bank in an economy (6 marks)
- c) Explain the classical theory of money demand (6 marks)