MACHAKOS UNIVERSITY

University Examinations for 2021/2022 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FOURTH YEAR ………… SEMESTER EXAMINATION FOR

BACHELOR OF ………………………………………

EAE 401: MONETARY THEORY AND POLICY

DATE: **TIME:**

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 conflicting objectives of monetary policy:

i) Crowding out between public and private sectors (2 marks)

ii) Globalization and policy objectives (2 marks)

iii) Full employment and economic growth (2 marks)

b) Explain how:

i) Judicious monetary policy promotes economic growth (2 marks)

ii) Counter-cyclical monetary policy promotes stabilization of prices (2 marks)

iii) Pro-active fiscal policy is a viable route for getting out of the vicious circle of poverty at mass level. (2 marks)

c) An economy is characterized with the following: Currency with the public = 84,000; Demand deposits with banks = 68,000; Other deposits with central bank = 3,612; Total deposits with post office = 22,500; Time deposits with banks = 200,555; Post office saving = 5,528. Calculate M1, M2, M3 and M4. (8 marks)

d) Based on Philips curve, Friedman/Phelps and Taylor curve, give a brief analysis of trade-off in the monetary policy (5 marks)

e) Using a well labeled diagram, explain the inverse relationship between the quantity of money and value of money based on Fischer's quantity theory of money (5 marks)

QUESTION TWO (20 MARKS)

a) Discuss the cash balances Approach of Cambridge equation. (6 marks)

b) Discuss four determinants of money supply. (8 marks)

c) Discuss three differences between Friedman and Keynesian quantity theory of money. (6 marks)

QUESTION THREE (20 MARKS)

a) With aid of a well labeled diagram demonstrate use of interest rate as a target of monetary policy (6 marks)

b) Graphically explain the relationship between money supply and High Powered money (8 marks)

c) Discuss three measures of money supply (6 marks)

QUESTION FOUR (20 MARKS)

a) With aid of a well labeled diagram explain Keynes reformulated quantity theory of money (6 marks)

b) Demonstrate the credit creation process by commercial banks (6 marks)

c) Explain for similarities between Fisher's Transaction Approach and the Cambridge Cash Balances Approach (8 marks)

QUESTION FIVE (20 MARKS)

a) Graphically demonstrate restrictive monetary policy and state four limitations associated with this policy. (8 marks)

b) With the aid of diagram explain the money balances analysis based on demand and supply of money (7 marks)

c) At a particular bank, the reserve ratio is 10% and excess reserves are $300. What is the maximum expansion of the money supply that can be generated by that bank. (3 marks)