DSVDL

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UNIVERSITY EXAMINATIONS
OPEN DISTANCE AND E-LEARNING
SEMESTER TWO EXAMINATIONS FOR THE DEGREE OF BACHELOR OF COMMERCE, ECONOMICS, EDUCATION AND AGRICULTURAL ENTERPRISE.
2019/2020
EAE 310: ECONOMICS OF MONEY AND BANKING

DATE ……………………… TIME 2 HRS

Externally moderated
03/02/2020

ANSWER QUESTION ONE AND ANY OTHER TWO

Question One

a) Suppose country K had the following monetary asset information as of April 2019:
Cash in hands of the public = Kshs 300b (where 'b' represents billion)
Demand Deposits (DD) = Kshs 400b
Other Checkable Deposits = Kshs 150b
Traveler's checks = Kshs 50b
Savings Type accounts = Kshs 2000b
Money Market Mutual Funds (MMMF) = Kshs 1000b
Small Time Deposits = Kshs 500b
Large Time Deposits = Kshs 450b
Required:

i) Calculate M_1 and M_2 for country K (4 Marks)

ii) calculate ~~What~~ is the money supply for country K? (3 Marks)

iii) Which item is not included in the calculations of M_1 and M_2? (1 mark)

b) (i) Distinguish between the terms deflation and inflation. (4 marks) 4 marks

(ii) How can an increase in the price levels affect the real value of money? (4mks)

c) Briefly explain how money supply affects the level of economic activity in any given economy. (4 marks) ~~(4mks)~~

d) Explain any five attributes that a commodity possesses in order to serve as money (10 ~~mks)~~ marks

Question Two

a) (i) Briefly explain Fisher's equation of exchange. ~~(2mks)~~ (2 marks)

(ii) Highlight four assumptions of Fisher's theory of nominal quantity of money. ~~(4mks)~~ (4 marks)

Combine (a)(i) and (ii) and reallocate marks

b) Explain any four causes of demand-pull inflation in an economy. ~~(8mks)~~ (8 marks)

c) Explain the term velocity of money and outline any two determinants of velocity of money.
~~(6mks)~~ (6 marks)

Question Three

a) Suppose that a person's annual income is Ksh.156000. Also assume that this person's money demand function is given by:

$$M^d = Ksh\, Y(0.25 - i)$$

where Md - Money demand, Y - Annual income, i - interest rate

i) What is this person's demand for money when the interest rate is 10% and 5%? (4~~mks)~~ marks)

ii) Using a graph, explain how the interest rate affects money demand. (3~~mks)~~ marks)

b) If the cash reserve ratio (r) = 0.25, what is the simple money multiplier? If reserves increase by Kshs 100, how much do deposits increase? (3 marks)

c) Suppose that the price level in Kenya is expected to rise by 6% over the next year. Discuss ~~What are~~ the costs associated with this expected inflation. Discuss ~~What~~ other costs will Kenya face if the inflation unexpectedly turns out to be 12%? (10 marks)

Question Four

(a) Discuss the transaction, precautionary, and speculative motives for holding money in Keynes liquidity preference theory. (6 ~~mks)~~ marks

(b) Explain four functions of money in a modern economy. (8~~mks)~~ marks)

(c) With the help of a graph, explain the concept of liquidity trap. (6 marks)

Question Five

a) Empirical studies have shown that non-bank financial Institutions in Kenya contribute to economic growth and development. Discuss five ways in which they do so. (10 ~~mks)~~ marks)

b) Suppose that the money market of green country has the following money supply and demand equations:

Money Supply: $M^s = 8000$

Money Demand: $M^d = 10{,}000 - 40{,}000r$

Where money is in billions of dollars and interest rates, r, is written as a decimal (e.g., an interest rate of 10% would be written as 0.1 in the equation).

i) Sketch the money supply and demand curves, putting the quantity of money on the horizontal axis and the interest rate (in percent) on the vertical axis. Indicate the slope and intercept of each curve. (4 marks)

ii) Calculate the equilibrium interest rate and amount of money. (3 marks)

c) Briefly explain why the interest and prices of bonds are negatively related. (3 marks)