MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS
2018/2019 ACADEMIC YEAR
THIRD YEAR FIRST SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF AGRIBUSINESS MANAGEMENT

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

DATE: 11TH DECEMBER, 2018 **TIME: 0830 - 1030 HRS**

INSTRUCTIONS TO CANDIDATES

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

This paper consists of 3 printed pages. Please turn over.

QUESTION ONE

a). 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 for several 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. **(4 marks)**

ii. Calculate how much velocity will change over the next year if the central bank follows the policy that achieves zero inflation. **(3marks)**

b) i. Define the concept money. **(3marks)**

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

c) Explain the objectives of money in less developed economies. Use examples and illustrations **(5marks)**

d) Differentiate between beater transaction and money transaction systems. **(4marks)**

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

QUESTION TWO

a) Explain factors responsible for banking crises in third world economies. **(3marks)**

b) Explain the neutrality of money concept. **(3marks)**

c) Discuss three major policy instruments adopted by central bank to control money supply. **(3marks)**

d) Explain the evolution of money policy in developing economies. **(3marks)**

e) Discuss the components of money. **(3marks)**

QUESTION THREE

a) Use examples and illustrations to explain the process of credit creation in banks. **(4marks)**

b) Discuss the macro-economic variables that affect the aggregate demand for demand. **(4 marks)**

c) Explain the relationship between the price level and the nominal money supply when all markets are in equilibrium. **(4 marks)**

d) Discuss how actions of the public and banks can cause the money multiplier to rise or fall. **(3marks)**

QUESTION FOUR

a) Explain the role of financial intermediaries in less developed economies. **(4marks)**

b) 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=0.4-2r

Where res is the reserve-deposit and r is the real interest rate. The currency-deposit ration is 0.4. the price level is fixed at 1.0 and the monetary base is 60. The real quantity of money demanded is L(Y,i) =0.5Y – 10i,

Where Y is 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=0.10

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)**

c) Describe the characteristics necessary for use of any commodity mark over a long period. **(3 marks)**

QUESTION FIVE

a) Explain how interest rates are determined under the following approaches

i. Classical **(3marks)**

ii. Keynesian. **(3marks)**

b) Explain the following concepts as used in economics of money and banking

i. Monetary transmission mechanism **(2marks)**

ii. Intermediate target **(1mark)**

iii. Fractional reserve banking **(2marks)**

iv. High powered money **(1mark)**

v. Liquidity trap **(1mark)**

c) Explain three functions of money. **(2marks)**

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