

KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

SECOND SEMESTER FOR THE DEGREE OF BACHELOR OF ECONOMICS

EAE 310: ECONOMICS OF MONEY AND BANKING

DATE: FRIDAY 12TH MAY 2017

TIME: 4:30 p.m. – 6:30 p.m.

INSTRUCTIONS : ATTEMPT QUESTION ONE AND ANY OTHER TWO QUESTIONS

Q1. a) Following is the balance sheet of a national bank.

Assets	Liabilities
Reserves ksh 100 million	Deposits ksh 180 million
Securities ksh 50 million	Net worth ksh 20 million
Loans ksh 50 million	

- i) If the required reserve ratio is 0.1, what is the amount of the bank's excess reserves? (4marks)
- ii) How much Kes worth of additional loans or securities can the bank acquire as assets? (4marks)
- iii) How much of an increase in the money stock could the bank's excess support if all banks in the banking system were to hold zero excess reserves? (4marks)

b) Demonstrate how introduction of money helped to enhance the economic growth and development of countries as compared to barter trade. (5marks)

c) State the Fishers quantity theory of money and discuss its relevance in the present financial system. (8marks)

d) What is the difference between commodity money and fiat money? Explain why Kenyan currency is a fiat money. (5marks)

Q2. a) Nominal GDP is ksh 5000 billion and the average daily stock of money measured by M1 during the year is ksh 1000 billion.

Required:

What is likely to happen to the demand for money and interest rates if there is :

- i) Increase in government purchases . (5marks)
- ii) Nominal GDP increases to ksh 5,500 billion while the M1 remains at ksh 1000 billion. (5marks)

- b) The level of interest rates in the economy increases on average over the year from 6% to 8%. What effect will this change have on quantity of money demanded?
(5marks)
- c) Explain how a decrease in the level of interest rates affect the quantity of money demanded in the economy.
(5marks)
- Q3. a) With the help of examples discuss the roles played by non banking financial institutions in economic growth and development in economy. (10marks)
- b) Give the reasons why the contributions of the commercial banks to the economic growth of developing countries is far much lower than for the developed countries.
(10marks)
- Q4. The Central Bank of Kenya has constantly been blamed for failures of many commercial and non financial institutions. Discuss.
(20marks)
- Q5. a) State and explain four core functions of money in an economy.
(10marka)
- b) Suppose inflation is expected to heat up in the future. How does inflation affect the function of money as a medium of exchange, standard for deferred payment and as a store of value?
(10marks)