CHUKA UNIVERSITY

COLLEGE

UNIVERSITY EXAMINATIONS

THIRD YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF SCIENCE IN AGRIBUSINESS MANAGEMENT

ECON 341: ECONOMICS OF MONEY AND BANKING

STREAMS: B.SC (AGBM) Y3S1 **TIME: 2 HOURS**

DAY/DATE: WEDNESDAY 3/8/2011 **8.30 A.M. – 10.30 A.M.**

INSTRUCTIONS

- Section A is compulsory.
- Answer any TWO questions in Section B.
- Do not write on the question paper.

SECTION A

QUESTION ONE

Q.1 (a) Explain what is meant by "an economy that is in a goods-market-equilibrium". [6 marks]

(b) Explain the concept of LM schedule. [4 marks]

(c) Suppose the Money-Market Model is as follows:

Money demand; $M_d = 0.4\,Y - 80\,r$
Money supply; $M_s = 1200$

Assume also that we have the following consumption and investment functions;

Consumption; $C = 600 + 0.7\,Y$
Investment; $Ip = 250 + 0.1\,Y - 10\,r$

Required:

(i) Determine the rate of interest at which the money market will be in equilibrium. [4 marks]

(ii) Determine the IS and LM schedules. [6 marks]

(iii) Determine the income and rate of interest at which both the goods,-market and money-market will be in equilibrium. [6 marks]

SECTION B

QUESTION TWO

Q.2 (a) What is the relationship between K in the Cambridge version of the quantity theory and velocity in Fisher's version? [6 marks]

(b) Given MV = PQ: and that the demand for money is a function of both income and interest rates; $M_d = h(Y, i)$; and that equilibrium requires that the money supply (M_s) equal money balances demanded (M_d).

Explain why prices will not always vary in proportion to the supply of money. [10 marks]

(c) If the economy is in a liquidity trap, what would happen to GNP if the money supply were increased? [6 marks]

QUESTION THREE

Q.3 (a) What is a money market? [4 marks]

(b) How does money market differ from capital market? [4 marks]

(c) Which are the main qualities shared by money market instruments? [6 marks]

(d) Discuss four money market instruments. [8 marks]

QUESTION FOUR

Q.4 (a) Explain the term monetary base. [4 marks]

(b) What are the three instruments of monetary control? How is each instrument related to the money supply process? [6 marks]

(c) What are some of the factors that complicate the administration of monetary policy? [6 marks]

(d) Suppose that reserve requirements on checkable deposites are 20 per cent (0.20) and that there are no time deposits and no currency leakages. Also assume that the Central Bank purchases KSh. 1,000,000 of treasury securities from a bank. What will be the final effect on;

(i) checkable deposits? [2 marks]

(ii) loans and investments? [2 marks]

(iii) reserves and monetary base? [2 marks]
