

MAASAI MARA UNIVERSITY

**REGULAR UNIVERSITY EXAMINATIONS**

**2016/2017 ACADEMIC YEAR**

**FOURTH YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS**

**BACHELOR OF ARTS IN ECONOMICS**

**COURSE CODE: ECO 421**

**COURSE TITLE: MONETARY THEORY AND POLICY**

**DATE: 10TH MAY 2017 TIME: 11:00 – 13:00HRS**

**INSTRUCTIONS TO CANDIDATES**

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

*This paper consists of* ***TWO*** *printed pages. Please turn over.*

**QUESTION ONE**

1. In the Baumol Transaction Demand for money model, money demand is determined by a number of factors. Mercy earns KES 50,000 per month and can invest the money in interest earning ventures at 5% per year.
2. What must be the per-transaction be to ensure that her average holdings are KES 10,000 per month? (**5mks)**
3. Assume her income changes to KES 60,000, the interest on saving moves to 4.5%, and the per-transaction cost moves to KES 3.12. What will be her new optimal money holding?    (**4mks)**
4. Comment on the relationship between the per-transaction cost and the demand for money holding by Mercy. (**1mk)**
5. With the aid of a well-labelled diagram, explain the concept of liquidity trap.     (**5mks)**
6. In the context of your country using suitable examples, discuss the functions of Non-Bank Financial Institutions(NBFI’s). (**10mks)**

**QUESTION TWO**

1. In the Kenyan context, explain the roles that the money market plays in the economy. (**7mks)**
2. Compare and contrast bank and Non-Bank Financial Institutions.    (**8mks)**

**QUESTION THREE**

1. Explain the key objectives of monetary policy in a country. (**7mks)**
2. Discuss the tools that the Central Bank of Kenya would use to effect its monetary policy functions. (**8mks)**

**QUESTION FOUR**

1. Discuss the Cambridge cash balance approach to demand for money. What are the key criticisms to this approach? (**8mks)**
2. Explain the Keynesian approach to money demand. (**7mks)**

**QUESTION FIVE**

1. Discuss the pros and cons of the barter system of trade. (**6mks)**
2. If the required reserve ratio ratio is ten percent, the currency in circulation is $400 billion, checkable deposits are $800 billion, and excess reserves total $0.8 billion. Calculate the money supply, monetary base and money the money multiplier. (**6mks)**
3. Explain any three properties that a commodity must possess to be used as money. (**3 mks)**

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