

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

2ND SEMESTER 2023/2024 ACADEMIC YEAR

SECOND YEAR EXAMINATION FOR THE DEGREE
BACHELOR OF SCIENCE IN ECONOMICS AND
STATISTICS

ECON .222: ECONOMICS OF MONEY AND BANKING

STREAM: *ECON-STAT*

TIME: *2 HRS*

DAY: *FRIDAY [2.30-4.30 P.M]*

DATE: *12/04/2024*

THIS QUESTION PAPER CONSISTS OF THREE (3) PAGES

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INSTRUCTIONS: Answer QUESTION ONE and other TWO QUESTIONS

QUESTION ONE

- a) Distinguish between the terms given below as used in Economics of money and banking.
 - i) Time deposits and Demand deposits. (2 marks)
 - ii) Fiat money and Fiduciary money. (2 marks)
 - iii) Real money balances and nominal money balances. (2 marks)
- b) Nominal GDP is Ksh 5000 billion and the average daily stock of money measured by M1 during the year is Ksh 1000 billion. What is likely to happen to the demand for money and interest rate if :
 - i) There is an increase in government purchases. (2 marks)
 - ii) Nominal GDP increases to Ksh. 5500 billion and M1 remains at Ksh 1000 billion. (2 marks)
- c) The level of interest rate in the economy increases on average over the year from 6 % to 8%. What effect does this change have on the quantity of money demanded? Illustrate graphically. (5marks)
- d)
 - i) Explain the Friedman Theory of money demand. (5 marks)
 - ii) Discuss the determinants of money demand based on the above theory. (4marks)
- e) Economic growth can be speeded up by accelerating the rate of savings and investment in the economy. How should monetary policy be conducted in order to raise aggregate level of savings and stimulate productive investments? (6 marks)

QUESTION TWO

- a)
 - i) Explain the Baumol inventory approach to transaction demand for money. (3 marks)
 - ii) Derive the underlying equation(s) in the Baumol inventory approach to transaction demand for money. (2marks)
 - iii) Explain the relationship between the variables in the final equation. (3 marks)
- b) Explain the core functions of money in an economy. (8 marks)
- c) Explain the role of central banks in an economy. (4 marks)

QUESTION THREE

- a)
 - i) Define the term Liquidity trap. (2 marks)
 - ii) Illustrate and explain the impact of central bank's sale of government securities when the economy is at the liquidity trap. (7 marks)

b) With reference to Tobin's portfolio approach to money demand, explain why people should keep a portfolio of asset consisting of both money and bonds. (6 marks)

c) Briefly explain the following terms as used in Money and Banking. (5 marks)

- i) Open market operations.
- ii) Liquidity preference.
- iii) Double coincidence of wants.
- iv) Money Illusion.
- v) Commodity money.

QUESTION FOUR

- a) Explain four objectives of monetary policy in an economy. (8 marks)
- b) i) Define the term credit creation. (2 marks)
ii) Explain the main limitations to the process of credit creation. (4marks)
- c) Explain three determinants of money supply in the economy. (6 marks)

QUESTION FIVE

a) Suppose that the money market of Kenya has the following money supply and money demand equations;

Money Supply: $M_S = 8000$

Money Demand: $M_D = 10000 - 40000r$

Where money is in millions and interest rate is written as a decimal (e.g. an interest of 10% would be written as 0.1 in the above equation)

- i) Sketch the money supply and demand curves, with quantity of money on the horizontal axis and interest rate on the vertical axis. (4 marks)
 - ii) Calculate the equilibrium interest rate and amount of money. (4 marks)
 - iii) Suppose the interest rate is currently at 10%, what is the amount of excess supply of or excess demand for money? How will the market adjust to equilibrium? (4 marks)
- b) With specific examples, discuss the importance of Non-banking financial institutions in the development process of Kenya. (8 marks)

