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Technology for Development

(University of Choice)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY (MMUST)

MAIN/BUNGOMA/NAIROBI/WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS 2021/2022 ACADEMIC YEAR

THIRD YEAR SPECIAL/SUPPLIMENTARY EXAMINATIONS

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF 307

COURSE TITLE: MONETARY THEORY AND PRACTICE

DATE: WEDNESDAY, 27TH JULY 2022 **TIME:** 8-10 AM

INSTRUCTIONS TO CANDIDATES

Answer **QUESTION ONE** and **ANY OTHER TWO (2)** questions

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

This Paper Consists of 3 Printed Pages. Please Turn Over.

QUESTION ONE(30 MARKS)

The `moneyness' of money

The demand for money has been a subject of lively debate in economics because of the fact that monetary demand plays an important role in the determination of the price level, interest and income. Till recently, there were three approaches to demand for money, namely, transaction approach of Fisher, cash balance approach of Cambridge economics, Marshall and Pigou and Keynes theory of demand for money. However, in recent years, Baumol, Tobin and Friedman have put forward new theories of demand for money.

An essential point to be noted about people's demand for money is that what people want is not 'nominal money' holdings, but 'real money balances'. This means that people are interested in the purchasing power of their money balances, that is, the value of money balances In terms of goods and services which they could buy. Thus people would not be interested in merely nominal money holdings irrespective of the price level, which is, the number of shilling notes and the bank deposits. If with the doubling of price level, nominal money holdings are also doubled, their real money balances would remain the same. If people are merely concerned with nominal money holdings irrespective of price level, they are said to suffer from 'money illusion'.

Required:

A. Explain why people's demand for money is not 'nominal money' holdings, but 'real money balances' using Friedman's modern quantity theory of money. (12 Marks)

B. If people are merely concerned with nominal money holdings irrespective of price level, they are said to suffer from 'money illusion'. Fisher explained this using the equation of exchange. Discuss in detail this statement. (10 Marks)

C. Baumol – Tobin model is a model of cash management. Using a diagram explain this statement. (8 Marks)

QUESTON TWO (20 MARKS)

A. Discuss the four major tools or instruments of monetary policy which can be used to achieve economic and price stability by influencing aggregate demand or spending in the economy. Use illustrations where necessary. (12 Marks)

B. What do you understand by the term monetary aggregate? Explain the main monetary aggregates used by monetary authorities. (8 Marks)

QUESTION THREE (20 MARKS)

A. According to Keynes it is because of the existence of liquidity trap that monetary policy becomes ineffective to tide over economic depression. With the aid of a diagram explain this statement. (12 Marks)

B. Compare and Contrast the Cash Balances approach and Fisher's quantity theory of money. (8 Marks)

QUESTION FOUR (20 MARKS)

A. Explain what you understand by the transmission mechanism of monetary policy. Discuss the four main channels through which monetary policy affects economic activities in the economy. (12 Marks)

B. Discuss the two main views relating to money demand. (8 Marks)