

UNIVERSITY OF SWAZILAND

FINAL EXAMINATION: 2006

TITLE OF PAPER: MONETARY ECONOMICS

COURSE CODE: ECON 401

TIME ALLOWED: 3 HOURS

- INSTRUCTIONS:**
- 1. ANSWER FOUR QUESTIONS:
TWO FROM SECTION A AND
TWO FROM SECTION B**
 - 2. ALL QUESTIONS CARRY
EQUAL MARKS OF 25 EACH**

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BEEN GRANTED BY THE INVIGILATOR**

Section A

Question 1

- a) Define 'financial repression'. (3)
- b) Outline the criticisms to the financial liberalisation theory. (6)
- c) The prior savings approach to the finance of development postulates that savings funds investment or that investment is limited by the availability of savings. Discuss how savings can be raised using monetary and fiscal policies. (16)

Question 2

Outline the main objectives and instruments of monetary policy in developing countries. Discuss the relevance of these instruments to Swaziland in light of her membership to the Common Monetary Area (CMA). (25)

Question 3

With the aid of algebra and/or diagrams, clearly explain why the speculative demand for money is a function of the expected rate of interest. State the criticisms advanced against this approach. (25)

Question 4

According to the multiplier model, the supply of money (M) is determined as:

$$M = \left(\frac{1+c}{r+c} \right) H$$

Where H = reserve or high-powered money

c = cash-deposit ratio

r = reserve-deposit ratio

- a) Examine in detail the practical usefulness of this approach to the measurement of broad money supply (M2) in Swaziland. (15)
- b) Compute the size of the multiplier, and analyse the economic consequences when $r = 0.4$ and $c = 0.6$. (5)
- c) With reference to (a) above, explain fully how you expect the decrease from 3% to 2.5% in the reserve requirement ratio in Swaziland will affect money supply. (5)

Section B

Question 5

- a) Evaluate the relevance of the “efficient market hypothesis” to developing countries’ stock markets. (20)
- b) Briefly explain the meaning and importance of risk diversification. (5)

Question 6

- a) With the aid of algebra, discuss how fluctuations in foreign reserves may affect domestic money supply. (15)
- b) Explain the meaning of sterilisation. What are the means of sterilisation? (10)

Question 7

Outline the monetary approach to the balance of payments. On the premise of this approach, show how currency devaluation may lead to an improvement in the balance of payments. (25)

Question 8

Friedman contends that monetary expansion cannot be used effectively to control the level of interest rates, employment or for fine tuning the economy and that any attempts to use monetary policy to achieve this, may give opposite results. Discuss. (25)