

**UNIVERSITY OF SWAZILAND**  
**FACULTY OF SOCIAL SCIENCE**  
**DEPARTMENT OF ECONOMICS**  
**FINAL EXAMINATION PAPER, MAY 2007**

**TITLE OF PAPER : MONETARY ECONOMICS**

**COURSE CODE : ECON 401**

**TIME ALLOWED : THREE (3) HOURS**

- INSTRUCTIONS :**
- 1. ANSWER FOUR (4) QUESTIONS: TWO (2) FROM SECTION A AND TWO (2) FROM SECTION B.**
  
  - 2. ALL QUESTIONS CARRY EQUAL MARKS OF 25 EACH.**

**THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.**

## SECTION A

### QUESTION 1

Economists define money as anything that is generally accepted in the payment for goods and services. Whether money is shells, rocks, gold or paper, it has three primary functions in any economy.

- a) Discuss these functions. (10)
- b) What are the characteristics of a money good? (5)
- c) What are the benefits enjoyed by the monetary economy which are not available to the barter economy? (10)

### QUESTION 2

Theory tells us that there is a link between money supply and high powered money (monetary base). Suppose that money supply in Swaziland is determined by M1, which is:  $M = C + D$  and high powered money is given by:  $H = C + TR$

Where: M = Money supply

C = currency in circulation

D = checkable deposits

H = High powered money

TR = Total reserves (required reserves + excess reserves)

- a) Derive the money multiplier and describe the link between money supply and high powered money. (15)
- b) Compute the size of the money multiplier when  $r = 0.3$ ,  $cr = 0.7$  and  $e(R) = 0.2$ . Note:  $r$  = reserve deposit ratio,  $cr$  = cash deposit ratio and  $e(R)$  = Excess reserves deposit ratio. (5)
- c) Using a) and b) above, how would you explain an increase from 0.3 to 0.5 in the required reserve ratio. How will this increase affect money supply? (5)

### QUESTION 3

Compare and contrast Keynes and Friedman's models of the theory of demand for money. What is the empirical evidence of the demand for money? (25)

#### **QUESTION 4**

- a) Outline the theory of Optimum currency area. (10)
- b) What are the implications of the Common Monetary Area (CMA) agreement for Swaziland? (10)
- c) In your view, is it beneficiary for Swaziland to continue being a member of the CMA or should she opt out? (5)

#### **SECTION B**

#### **QUESTION 5**

- a) Define Financial Repression. (3)
- b) Explain why there is financial repression in many developing countries (18)
- c) What is the solution to financial repression? (4)

#### **QUESTION 6**

- a) Discuss the main functions of the Central Bank of Swaziland. (10)
- b) Explain the characteristics of the informal financial sector and its impact on monetary policy. (15)

#### **QUESTION 7**

- a) Explain and graphically show how fiscal policy works with capital mobility under a fixed exchange rate regime. (12.5)
- b) Explain and graphically show how fiscal policy works with capital mobility under a flexible exchange rate regime. (12.5)

#### **QUESTION 8**

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