

**UNIVERSITY OF SWAZILAND  
FACULTY OF SOCIAL SCIENCE  
DEPARTMENT OF ECONOMICS  
MAIN EXAMINATION  
DECEMBER 2014**

TITLE OF PAPER: MONETARY THEORY

COURSE CODE: ECON 402

TIME ALLOWED: THREE (3) HOURS

INSTRUCTION: ANSWER ANY **FOUR** QUESTIONS

DO NOT OPEN THIS PAPER UNTIL PERMISSION HAS  
BEEN GRANTED BY THE CHIEF INVIGILATOR.

### Question 1

- a) Discuss factors that are likely to affect the public's cash ratio and the reserve ratio of banks. (10 marks)
- b) Money supply is set endogenously in Swaziland. Do you agree? Explain. (5 marks)
- c) Distinguish between core and headline inflation. State the current rate of both in Swaziland. Do the figures reflect an increase or decrease between October and November 2014. What factors have contributed to this development in inflation? (10 marks)

### Question 2

- a) Outline Keynes's liquidity preference theory. (5 marks)
- b) Outline any two criticisms leveled against Keynes's theory. (5 marks).
- c) Empirical research on money demand focusses on two main issues. Explain. (5 marks)
- d) Discuss Friedman's theory of the demand for money. Be sure to state the equation and define all the variables. (10 marks)

### Question 3

- a) Define the term rate of interest. Differentiate between simple and compound interest. (5 marks)
- b) Differentiate between a real and nominal interest rate. Outline Fischer's equation that relates these interest rates. Be sure to define all variables. (10 marks)
- c) Outline the factors that can shift the supply and demand curve for bonds. (10 marks)

### Question 4

- a) Differentiate between a spot and forward market for exchange rate. (5 marks)
- b) What are the current real and nominal effective exchange rates in Swaziland? Why are these useful in the economy? (5 marks)
- c) Discuss in detail the three main functions of the foreign exchange market. (15 marks)

### Question 5

- a) Differentiate between underlying instruments and derivatives. (5 marks)

- b) Outline the main functions of Financial Services Regulatory Authority (FSRA). In your opinion is it beneficial for the financial system to have this authority? Explain. (10 marks)
- c) Describe how the Central Bank of Swaziland supervises the banking sector in Swaziland. (10 marks)