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UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

SUPPLEMENTARY EXAMINATION

JULY 2018

TITLE OF PAPER:	**MONETARY THEORY**
COURSE CODE:	**ECON 402**
TIME ALLOWED:	**2 HOURS**
INSTRUCTIONS:	**ANSWER QUESTION ONE (1) AND ANY TWO (2) OTHER QUESTIONS** **QUESTION ONE CARRIES 40 MARKS. THE REST OF THE QUESTIONS CARRY 30 MARKS EACH**

Question One (Compulsory) **(40 Marks)**

1. (a) Discuss the differences between Friedman's and Keynes' theories of money demand. [15]

(b) Illustrate graphically how cost-push inflation arises with an activist policy to promote high employment. What roles do fiscal and monetary policies play in causing cost-push inflation? [20]

(c) Explain why bond prices and market interest rates are inversely related? [5]

Answer Any Two (2) of the Following Questions: **(30 Marks Each)**

2. (a) Briefly explain the meaning of asymmetric information and how this could lead to the problems of adverse selection and moral hazard in financial markets. Give examples to support your answer. [10]

(b) The money multiplier equation is given by:

$$m = \frac{1 + c}{c + r + e}$$

What do the variables *r*, *e* and *c* represent? What will be the effect of an increase in each of these variables on the multiplier? [10]

(c) Outline the lags that delay the effectiveness of the "activists" policies [10]

3. (a) State the main functions of the Central Bank of Swaziland [12]

(b) Outline the factors that influence asset demand [8]

(c) What impact did the introduction of credit cards have on the velocity of money? [5]

(d) Distinguish between the risk structure and term structure of interest rates. [5]

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4. (a) Show, using the Quantity Theory of Money, that money is neutral. [10]

   (b) Explain how a sudden increase in people's expectations of future real estate prices would affect interest rates? [5]

   (c) With the aid of a diagram, explain why a rise in the price level (but not expected inflation) would cause interest rates to rise when the nominal money supply is fixed? [10]

   (d) State the budget deficit constraint and explain how deficit financing affects the money supply? [5]