UNIVERSITY OF ESWATINI

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

MAIN EXAMINATION

DECEMBER 2018

TITLE OF PAPER:	MONETARY THEORY
COURSE CODE:	ECO 401/ 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

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

1. (a) (i) According to Keynes' Liquidity Preference Theory, if interest rates decline so that they are close to zero, what will happen to the demand for money? Include the assumptions of the Theory in your discussion. [8]

(ii) Explain why the Liquidity Preference Theory predicts that an increase in the money supply does not necessarily lead to a decrease in the interest rates over the longer term. Be sure to explain all the different effects. [18]

(b) In contrast to Keynes, why does Friedman think that the demand for money is not affected by changes in interest rates? [14]

Answer Any Two Questions From The Following: **[30 Marks Each]**

Question Two

2. (a) With the aid of diagrams, discuss the following statement: "a cost-push inflation occurs as a result of workers' attempts to push up their wages. Therefore, inflation does not have to be a monetary phenomenon." Include an explanation of both the short-run and long-run cases in your discussion. [30]

Question Three

3. (a) State the assumptions and predictions of the Expectations Theory of the term structure of interest rates. Be sure to state how well the theory explains the three empirical observations of the yield curve. [15]

(b) With the aid of a diagram, compare the "activists" and "non-activists" policies to correct for high unemployment in the economy. [15]

Question Four

4. (a) (i) Define velocity and state its role in the classical version of the Quantity Theory of Money. [5]

(ii) Discuss how actions of the public and banks can cause the money multiplier to rise or fall. Does the fact that the public and banks can affect the money multiplier imply that the central bank cannot control the money supply? Use the money multiplier equation to explain your answer. [12]

(b) Some economists believe that one of the reasons that economies in developing countries grow slowly is that they do not have well developed financial markets. Is that true? [5]

(c) What is a financial market? Distinguish between financial markets in each of the classifications below and state the basis for classification in each case.

(i) Primary markets and secondary markets

(ii) Money markets and capital markets [8]