UNIVERSITY OF ESWATINI

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

RE-SIT/ SUPPLEMENTARY EXAMINATION

JANUARY 2019

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) Regarding the velocity of money, discuss how Friedman's view differs from that of Keynes? [25]

(b) Assume that the quantity theory of money holds and that velocity is constant at 5. Output is fixed at its full-employment value of 10,000, and the price level is 2.

(i) Determine the real demand for money and the nominal demand for money. [9]

(ii) In this same economy the government fixes the nominal money supply at 5000. With output fixed at its full-employment level and with the assumption that prices are flexible, what will be the new price level? What happens to the price level if the nominal money supply rises to 6000? [6]

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

Question Two

2. (a) Distinguish between the Keynesian and Monetarists' views on factors that cause the aggregate demand curve to shift. [14]

(b) Explain how each of the following would affect the money supply-: [8]

(i) Banks decide to hold more excess reserves

(ii) People withdraw cash from their bank accounts for Christmas shopping

(iii) The introduction of ATMs, which allow people to withdraw cash from the bank as needed, makes deposits relatively more convenient.

(iv) The government sells E20 billion of new government bonds to the central bank in order to finance its expenditure.

(c) How does the Central Bank of Eswatini exercise control over the monetary base? [8]

Question Three

3. (a) Using the Aggregate Demand and Aggregate Supply framework, illustrate the self-correcting mechanism of an economy that is functioning below its natural rate level of output. [14]

(b) Define risk structure of interest rates. List and explain the factors which affect the risk structure of interest rates using a supply of/ demand for bonds framework. [10]

(c) Describe the role of the money market in the financial system [6]

Question Four

4. (a) With the aid of a diagram, discuss the effect of an increase in expected inflation on interest rates, using the supply of/ demand for bonds framework. [20]

(b) State the two types of inflation that can result from an activist stabilization policy to promote high employment [5]

(c) Outline the budget deficit constraint and explain how deficit financing affects the money supply [5]