



# UNIVERSITY OF ESWATINI

FIRST SEMESTER MAIN EXAMINATION PAPER, NOVEMBER 2019

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO 401

TITLE OF PAPER: MONETARY THEORY

TIME ALLOWED: 2 HOURS

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## Instructions

1. This paper consists of Section (A) and (B).
2. Section A is compulsory.
3. Answer any two questions from Section B.

## Special Requirements

Scientific calculator

*Candidates may complete the front cover of their answer book when instructed by the Chief Invigilator and sign their examination attendance cards but must **NOT** write anything else until the start of the examination period is announced.*

*No electronic devices capable of storing and retrieving text, including electronic dictionaries and any form of foreign material may be used while in the examination room.*

**DO NOT turn examination paper over until instructed to do so.**

## SECTION A

### QUESTION 1 (Compulsory)

**(40 Marks)**

“Economists define money as anything that is generally accepted in the payment of goods and services. Whether money is in a form of: shells, rocks, gold or paper; it has three primary functions in any economy.”

- a) Discuss in detail these three primary functions of money. **(15)**
- b) What are the characteristics of money good? **(10)**
- c) What are the benefits enjoyed by the money economy which are not available in the barter economy? **(15)**

## SECTION B

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

**(30 Marks Each)**

### QUESTION 2

Theory tells us that there is a link between money supply and the high powered (monetary base). Suppose that money supply in Eswatini is determined by M1, which is:  $MS = C + D$  and the high powered money is defined as follows:  $H = C + TR$

Where: MS = money supply

C = currency in circulation

D = checkable deposits

H = high powered money/monetary base

TR = total reserves (required reserves + excess reserves)

- a) Derive the money multiplier and describe the link between money supply and the high powered money. **(20)**
- b) Compute the size of the money multiplier when  $r = 0.3$ ,  $cr = 0.7$  and  $er = 0.2$ . Note:  $r =$

reserve ratio,  $cr$  = cash deposit ratio and  $er$  = excess reserve 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? (30)

### **QUESTION 4**

- a) What are the main objectives of the establishment of the Central Bank of Eswatini? (10)
- b) One notable feature of the commercial banking system in Eswatini is the excess liquidity. What are the implications of this problem for the kingdom of Eswatini? (10)
- c) What are the factors that have contributed to the excess liquidity problem in the banking system of Eswatini? (10)

\*\*\*\*\***GOOD LUCK**\*\*\*\*\*