UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCE

DEPARTMENT OF ECONOMICS

SUPPLEMENTARY EXAMINATION

JULY 2015

TITLE OF PAPER: MONETARY THEORY

COURSE CODE: ECON 402

TIME ALLOWED: THREE (3) HOURS

INSTRUCTION: ANSWER ANY **FOUR** QUESTIONS

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Question 1

State the assumptions of the Mundell-Fleming model and provide a graphic presentation of this model. Be sure to explain the graph. Outline the shortcomings of this model. (25 marks)

Question 2

a) Outline how the payment system has evolved over time. (5 marks)

b) Financial intermediaries play a pivotal role in the financial system of any country. Explain. (10 marks)

c) Describe the buffer stock approach to the demand for money . (10 marks)

Question 3

a) Delineate monetary economics. Why is it important tó study it? (5 marks)

b) Given that money supply $M = Bm$ and; $m = \alpha + 1 \big/ \alpha + \beta$ where B is the monetary base and m is the money supply multiplier, α is the cash ratio and β is the reserve ratio.

(i) Outline the factors that influence α and β. (10 marks)

(ii) Why do banks hold free reserves? (2 marks)

(iii) Is the money supply determined endogenously or exogenously? Support your answer. (5 marks)

(iv) Name the four players in the money supply process. (3 marks)

Question 4

Write short notes on each of the following:
a) Coupon and discount bonds
b) Motives for holding money
c) Keynes' view on money's velocity of circulation
d) Functions of the foreign exchange market
e) Relative and absolute purchasing power parity

(5 marks each)

Question 5

a) Define the term rate of interest. Distinguish 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)

a) Outline the factors that can shift the supply and demand curve for bonds.

(10 marks)