

**UNIVERSITY OF SWAZILAND**  
**FACULTY OF SOCIAL SCIENCES**  
**DEPARTMENT OF ECONOMICS**  
**MAIN EXAMINATION**  
**DECEMBER 2016**

**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

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THE CHIEF INVIGILATOR.**

**Question One (Compulsory)**

1. (a) State the Friedman's and Keynesian money demand functions, and discuss the differences between the two theories of money demand. [30]
- (b) Distinguish between the Keynesian and Monetarists views on factors that cause the aggregate demand curve to shift. [10]

**Answer Any Two Questions From The Following:**

2. (a) With the aid of diagrams, discuss the effectiveness of expansionary monetary and fiscal policies in the IS-LM model when money demand is interest-inelastic. [20]
- (b) Outline the factors that cause the Aggregate Supply Curve to shift. [10]
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. [12]
- (ii) What do the "activists" and "non-activists" say about this self-correcting mechanism? [8]
- (b) Suppose there was a financial crisis similar to the recent Global Financial Crisis, which led to an increase in bank panics. Explain in detail the effects on the money supply of:
- (i) Depositors withdrawing their money from their bank accounts in fear that they would suffer losses on their deposits [5]
- (ii) Increased excess reserves as a result of the Central Bank making reserves costless. [5]
4. (a) Discuss the determinants of the Speculative Demand for holding money [18]
- (b) Outline the balance sheet of the Central Bank and explain how it uses its assets and liabilities to determine the monetary base. [12]
5. (a) Describe the two types of inflation that can result from an activist stabilization policy to promote high employment [5]
- (b) Outline the budget deficit constraint and explain how deficit financing affects the money supply [5]
- (c) With the aid of a diagram, illustrate how cost-push inflation arises as a result of government accommodation policy to promote high employment [20]