



THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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MAIN EXAMINATION

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MAY – AUGUST 2021

Ext 1022/23/25

FACULTY OF ARTS AND SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

REGULAR PROGRAMME

ECN 402: MONETARY THEORY & POLICY

Date: AUGUST 2021

Duration: 2 Hours

INSTRUCTIONS: Answer Question ONE and any other TWO Questions

**Q1**

- a) Outline the main propositions of the Keynesian theory of demand for money. (5 marks)
- b) Define money supply and give its measures. (5 marks)
  - a. Outline the problems associated with credit rationing. (5 marks)
  - b. Outline the objectives of monetary policy in an open economy. (10 marks)
  - c. Explain and illustrate the Bank/Deposits multiplier:  $1/L$ . (5 marks)

**Q2.**

- a. Compare and contrast Tobin's portfolio and Baumol's inventory approaches/theories of demand for money. (10 marks)
- b. Explain and illustrate the determinants of money supply in an open economy. (10 marks)

**Q3.**

- a. Trace through the interest rate transmission mechanism of an increase in money supply in the economy. (10 marks)
- b. Explain 5 sources of funding for a public sector deficit (PSBR) in an open economy. (10 marks)

**Q4.**

- a. Explain Friedman's view of monetary policy and highlight its shortcomings. (10 marks)
- b. Explain and illustrate the effect of the following on equilibrium rate of interest:
  - i. Banks find they have a higher liquidity ratio than they need. (5 marks)
  - ii. A fall in people's incomes. (5 marks)

**Q5.**

- a. Explain the techniques used to control money supply in an open economy. (10 marks)
- b. Outline the problems associated with controlling interest rates in an open economy. (10 marks)

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