

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]
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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]
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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]
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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]