

**UNIVERSITY OF SWAZILAND**  
**FACULTY OF SOCIAL SCIENCES**  
**DEPARTMENT OF ECONOMICS**  
**MAIN EXAMINATION**  
**DECEMBER 2017**

**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**

**Question One (Compulsory)****(40 Marks)**

1. (a) (i) Derive and explain the simple multiple deposit creation model. [7]  
(ii) Critique the model in (i) above. [8]
- (b) Briefly discuss any 5 factors that cause variation in the velocity of money. [10]
- (c) Discuss Friedman's proposition that inflation is always and everywhere a monetary phenomenon. [15]

**Answer Any Two (2) of the Following Questions:****(30 Marks Each)**

2. (a) State any three functions performed by financial intermediaries and explain how they can promote economic efficiency. [9]
  - (b) Describe the role of the money market in the financial system [6]
  - (c) With the aid of a diagram, compare the "activists" and "non-activists" policies to correct for high unemployment in the economy. [15]
3. (a) Illustrate with the aid of a diagram the flow of funds through the financial system. [12]
  - (b) Outline the factors that determine the risk structure of interest rates. [8]
  - (c) Explain why Keynes (1936)'s Liquidity Preference Theory predicts that both nominal income and interest rates affect the demand for money? [10]
4. (a) Using the AD- AS framework, illustrate the self-correcting mechanism of an economy that is functioning above its natural rate level of output. [12]
  - (b) Explain why, according to Friedman, changes in interest rates have little effect on the demand for money? Why is the money demand function stable in his view? [12]
  - (c) Define risk premium and state its two components. [6]