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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2022/2023 ACADEMIC YEAR
THIRD YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 29th July, 2022
Time: 2.30pm –4.30pm

KFI 303 - MONETARY THEORY AND POLICY

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE(COMPULSORY) AND ANY OTHER TWO QUESTIONS

Do not write on the question paper

Show your working clearly

QUESTION ONE (30 MARKS)

- a) Distinguish between the following terms as used in monetary economics (4 Marks)
- i) Monetary policy and monetary theory (4 Marks)
 - ii) Liquidity trap and money illusion (4 Marks)
 - iii) Floating exchange rate and fixed exchange rate (4 Marks)
- b) Using any four relevant examples, discuss how the objectives of monetary policy can sometimes conflict in an economy (8 Marks)
- c) Assume central bank of an economy has put the required reserve ratio (r) as 10%. Assume that the banking system has excess reserves equal to \$ 4 billion. Further, the currency in circulation equals \$ 450 billion, and the total amount of checkable deposits equals \$900 billion. Based on these numbers, calculate:
- i) Required reserves held by the banking system (2 Marks)
 - ii) Total reserves held by the banking system, (2 Marks)
 - iii) Monetary base (2 Marks)
 - iv) Total money supply ($M1$) (2 Marks)
 - v) The money multiplier (2 Marks)

QUESTION TWO (20 MARKS)

- a) Explain intuitively how the money multiplier changes when
- i) The required reserve ratio increases, (3 Marks)
 - ii) The currency to deposit ratio increases, (3 Marks)
 - iii) The excess reserve to deposit ratio increases. (3 Marks)
- b) Is the Central bank of Kenya Independent? Use the various aspects of Central bank independence to explain your answer. (8 Marks)

QUESTION THREE (20 MARKS)

- a) Describe the following channels of monetary policy transmission (use relevant examples).
- i) Traditional interest-rate effects (3 Marks)
 - ii) Assets price effects (9 Marks)
- b) Using mathematical analysis that underline Baumol-Tobin model, explain the assumptions made by the model and derive the Square Root Rule. (8 Marks)

QUESTION FOUR (20 MARKS)

- a) i) Differentiate between a Target Zone Arrangement and a Balance of Payment Crisis (4 Marks)
- ii) Explain any four advantages of a target zone arrangement (4 Marks)
- b) Explain Expansionary Monetary Policy when a country has a Flexible Exchange Rate regime (Use a well explained diagram) (12 Marks)

QUESTION FIVE (20 MARKS)

- a) Illustrate the link between a country's balance of payments and its money supply that suggests that fluctuations in central bank reserves can be thought of as the result of changes in the money market. (12 Marks)
- b) Explain the Ineffectiveness of monetary policy in Keynes view (Use well labelled diagrams) (8 Marks)