

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR  
OF COMMERCE

BCOM 333: MONEY AND BANKING

STREAMS: BCOM

TIME: 2 HOURS

DAY/DATE: FRIDAY 07/12/2018

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS: Answer question ONE and any other TWO questions

SECTION ONE (COMPULSORY) – 30 MARKS

QUESTION ONE

- (a) (i) Determine the optimal strategy for cash management for a person who earns ksh 16000 per month who can earn 5 percent interest per month in a saving account and has a transaction cost of ksh 200

[8 marks]

- (ii) What is the individuals average cash balance [4 marks]  
(iii) Suppose income rises to ksh 18000. By what percent does the individual demand for money change [6

marks]

- (b) The commodity and money markets in a hypothetical economy are given as below:

Commodity market

$$Y=C+I$$

$$C=120+0.4Y$$

$$I=1800-2.1r$$

Money Market

$$L_t=0.3Y$$

$$L_s=10-2r$$

$$M_s=1450$$

**Required:**

- (i) Derive the IS and LM curves and equilibrium Y and r. [6 marks]
- (ii) If money supply is increased by 50, what will be the equilibrium variables [4 marks]

**QUESTION TWO**

- (i) Explain the effect of inflation on functions of money [5 marks]
- (ii) Using an example, explain the process of credit creation by the commercial banks. What are the limits to this process? [10 marks]
- (iii) Discuss the likely effect of expansionary monetary policies in an economy? [5 marks]

**QUESTION THREE**

- (i) What role do the non-bank financial institutions play in economic growth of a growing economy like Kenya? [6 marks]
- (ii) Using a diagram explain the concept of liquidity trap [4 marks]
- (iii) Explain the five major functions of commercial banks [10 marks]

**QUESTION FOUR**

- (i) Discuss Milton Friedman's theory of demand for money. Explain why Friedman advocated for monetary policy more than fiscal policy [10 marks]
- (ii) Explain the role of financial intermediaries in the economic development of less developed countries [10 marks]

**QUESTION FIVE**

- (i) Describe two innovations that have led to the growth of the financial sector in Kenya [6 marks]
- (ii) Discuss the relationship between interest rates and the demand of money balances as postulated by J.M Keynes [7 marks]

(iii) Explain why monetary policies are not very effective in most of less developed countries

[7

marks]

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