University of Colombo - Sri Lanka

Third Year Examination in Arts (Economics) – 2018

(End of First Semester)

ECN - 3161: Monetary Economics and Policy

Time: Two (02) hours only

Answer four (04) questions only

1.

   i. Briefly explain the main functions of money. (04 Marks)

   ii. How do you describe the evolution of money from barter to modern monetary systems? (06 Marks)

   iii. "Existence of money makes the economy more efficient" Do you agree with this statement? Explain your answer. (05 Marks)

2.

   i. Examine the Classical tradition of Demand for money. (04 Marks)

   ii. Do you consider the Keynesian Theory of Demand for money, a significant step forward when compared with Classical theory of demand for money? Explain your answer. (06 Marks)

   iii. Describe the key factors behind the demand for money in your economy using your theoretical knowledge on demand for money. (05 Marks)

3.

   i. Define monetary policy. Briefly explain how monetary policy is used to achieve macro-economic objectives. (06 Marks)

   ii. What are the major monetary policy instruments used by the Central Bank. Explain your answer. (04 Marks)

   iii. "Independence of the Central Bank is vital for better monetary management". Explain the statement taking examples from Sri Lanka. (05 Marks)

4.

   i. What do you understand by deposit creation process by the Banking System? (04 Marks)

   ii. Suppose that the Central Bank purchases Rs. 100,000 worth bonds from a bank and pays by a cheque worth Rs. 100,000. As a result of this transaction, explain what will happen to the monetary base. Use Central Bank Balance Sheet to explain your answer. And If the Central Bank sells Rs. 100000 worth bonds to a nonbank public, explain the changes happen to the monetary base. (06 Marks)

   iii. "A shift from deposit to currency will have no effect on the monetary base" Do you agree with the statement? Explain your answer. (05 Marks)

5.

   i.   Prove that MS = m ×MB

              where, m $= \frac{1+c}{r+e+c}$ (06 Marks)

   ii. Explain the role of three major players of the monetary system using extended money multiplier approach.   (04 Marks)

   iii. Calculate the money supply using MS=m ×MB. The following information is given to you.

           1. Required reserve ratio (r) – 15%
           2. Currency in circulation (C) – Rs. 1000 million
           3. Checkable deposits   (D) – Rs. 2000 million
           4. Excess reserves (ER) – Rs. 1 million   (05 Marks)

6.

   i.   Briefly explain how monetary policy targets are set by a Central Bank.

                                           (04 Marks)

   ii. What do you understand by the Monetary Transmission Mechanism? Explain the credit channel of monetary transmission mechanism. (05 Marks)

   iii. Explain the relationship between Central Bank credibility and the effectiveness of monetary policy.   (06 Marks)

7.   Briefly describe any **three (03)** of the following.

   i.   Capital Market
   ii. High Powered Money
   iii. Exchange rate channel of monetary transmission mechanism
   iv. Expected Inflation Rate
   v.   The relationship between interest rate and price of bonds
   vi. "Inflation is always and everywhere a monetary phenomenon".

                                           (05 Marks for each)