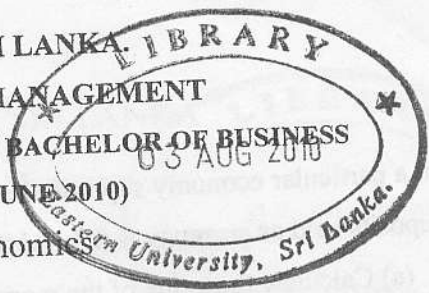


EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT
THIRD YEAR 2ND SEMESTER EXAMINATION IN BACHELOR OF BUSINESS
ADMINISTRATION 2008/2009 (JUNE 2010)
DBE 3113 Monetary Economics



Time 3 Hours

Answer all Questions

1. a. Explain the functions of money in an economy. (04 Marks)
- b. Explain the speculative demand for money and how is it related to the rate of interest. (08 Marks)
- c. "According to Tobin, rational behavior induces individual to hold a wealth portfolio which comprised of both bonds and money" Explain. (08 Marks)

2. a. What are the main factors that cause cost-push inflation? How may it be controlled? (04 Marks)
- b. Briefly explain the inflationary gap with diagram. (04 Marks)
- c. Explain the effects of inflation on
 - (i) Creditors and debtors and (02 Marks)
 - (ii) Persons of fixed income group. (02 Marks)
- d. Distinguish between short run and long run Phillips curve. (08 Marks)

3. Explain the following statements.
 - a. "An ultimate objective of monetary policy is to control inflation." (05 Marks)
 - b. "Credit cards perform all of the theoretical functions of money." (05 Marks)
 - c. "According to the theory of the demand for money, the transactions demand for money is proportional to income and does not depend on the rate of interest." (05 Marks)
 - d. "The Central Bank functions as banker to the government." (05 Marks)

4. In a particular economy suppose the value of high powered money is £500m, the fraction of deposits held as currency is 0.4 and that the fraction of deposits held as reserves is 0.1.

(a) Calculate the value of the money supply in this economy. (06 Marks)

(b) If the stock of high powered money increases to £600m what are the new value of the money supply? (06 Marks)

(c) What are the main determinants of high powered money? (08 Marks)

5. a. Explain the limitations of banks power of creating credit. (08 Marks)

b. Assume that 'A' is a single monopoly commercial bank and spread over the 'n' number of deposit rounds, using Rs.1000 demand deposit, Rs. 800 net additional loan, and Rs. 200 reserves. Calculate 2nd, 3rd, 4th and 5th round of demand deposits, net additional loan and net additional reserves. (12 Marks)