

**UNIVERSITY OF FORT HARE**

**MONETARY ECONOMICS  
ECO 516/516E**

**SUPPLEMENTARY EXAMINATION**

**JANUARY**

**2019**

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**Time: 3 Hours**  
**Subject: ECO 516/516E**  
**Marks: 100**

**This paper consists of 3 pages including the cover page**

**Internal Examiners**  
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**INSTRUCTIONS**

Answer any **FOUR** questions  
Make use of **relevant examples** where applicable. The graphical illustrations must be clearly shown.

### **Question 1**

- a) With reference to classical theories of money demand, discuss the variables that contribute to the stability of velocity of money. [10]
- b) Outline the stylised characteristics of the yield curve. How do the expectations and segmented market hypotheses try to explain these observable facts? [15]

### **Question 2**

- a) Discuss the main tenets of the Baumol-Tobin model. How does this differ from Keynes's liquidity preference theory? [10]
- b) The main assumptions of new classical economics include rational expectations and continuously clearing markets. Define the concepts and critically discuss how applicable they are to the analysis of modern day economic behaviour and in particular to the South African context. [15]

### **Question 3**

Monetary policy in South Africa is conducted using the inflation targeting framework.

- a) What is meant by inflation targeting? Outline the major tenets or characteristics of this framework. [5]
- b) Briefly discuss the reasons behind South Africa's adoption of the inflation targeting framework. [8]
- c) In order for inflation targeting to be successful, there are key institutional arrangements that must be in place. Discuss these arrangements with respect to how South Africa has adopted them. [12]

**Question 4**

- a) Interest rates are often said to be the price of loanable funds. What are the main 'sectors' in the loan market? Briefly outline whether a sector is likely to be a net borrower or a net lender. Justify [10]
- b) Define the concepts credibility and time consistency in monetary policy formulation. What is the relationship between these two concepts and how are they related to the independence of the central bank. [10]

**Question 5**

- a) What do we mean by the monetary transmission mechanism? Give examples [4]
- b) Why is it difficult to identify the precise monetary transmission mechanism in response to a policy change? [8]
- c) Discuss the advantages and disadvantages of rules versus discretion in the design of monetary policy. [13]

**Question 6**

Critically examine the McKinnon-Shaw and the Stiglitz-Weiss explanation of credit rationing in banking markets. Discuss the impact that asymmetric information may have on bank lending policy. [25]