

UNIVERSITY OF FORT HARE

**Money, banking and International
Finance
ECO 326/ECO 326E**

SUPPLEMENTARY EXAMINATIONS

JANUARY

2019

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Time: 3 hours

Subject: ECO 326/ ECO 326E

Marks: 100

This paper consists of 3 pages including the cover page

Internal Examiners

Dr C. Mlambo

External Examiners

Prof A Maredza

INSTRUCTIONS

**Answer all questions
All questions carry equal marks**

QUESTION ONE

Using both the liquidity preference framework and supply and demand for bonds framework, show why interest rates are procyclical (rising when the economy is expanding and falling during recessions) (25)

QUESTION TWO

An important way in which the Central Bank decreases the money supply is by selling bonds to the public. Using a supply and demand analysis for bonds, show what effect this action has on interest rates. Is your answer consistent with what you would expect to find with the liquidity preference framework (25)

QUESTION THREE

"A good theory of the term structure of interest rates must explain three empirical facts:

- 1. Interest rates on bonds of different maturities move together over time.*
- 2. When short-term interest rates are low, yield curves are more likely to have an upward slope, and when short-term rates are high, yield curves are more likely to become inverted.*
- 3. Yield curves almost always slope upwards."*

Discuss the three theories of the term structure; highlighting the one which does a good job in explaining the three empirical facts (25)

QUESTION FOUR

- (i) Discuss the differences between Friedman's money demand theory and Keynes' money demand theory (10)
- (ii) Define the main functions of financial intermediaries (15)