Examination Period 3: 2017/18

ECN201618N

Module Title: Financial and Banking Economics
Level: Five
Time Allowed: Two hours

Instructions to students:
- Enter your student number not your name on all answer books.
- Answer all questions from Section A and Section B and one question from Section C.
- Begin each question on a separate page; label each page clearly with the number of the question you are answering.
- The use of a non-programmable calculator is permitted.

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Section A

Answer all questions.

1. Briefly explain why the money supply is endogenous. (15 marks)

2. Briefly critically evaluate arguments in favour and against financial market efficiency. (12 marks)

3. Write down the monetary base multiplier and briefly explain each term. (5 marks)

4. Write down the flow of funds identity and briefly explain each term. (8 marks)

Total: 40 marks
Section B

Answer all questions.

5. Monetary policy making

a. Explain how a central bank uses repurchase agreements to target a specific interest rate. (5 marks)

b. Using a suitable model and diagram, describe the interaction between the non-bank private sector, the banking system and the central bank, assuming that the central bank pursues an interest rate policy and that money supply is endogenous. Make sure you start from the central bank setting a new short-term interest rate. (15 marks)

c. Using the framework you developed in part b, explain how the credit crunch affected these interactions. (10 marks)

Total: 30 marks

End of Section B
Section C follows overleaf

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Section C

Answer one question from this section.

6. Money demand
   a. Explain what determines money demand in the Baumol-Tobin model and why. (10 marks)
   b. Compare and contrast these money demand determinants with those of other models of money demand. (10 marks)
   c. Briefly explain why money demand is unstable according to the general theory view. (10 marks)

Total: 30 marks

7. Inflation targeting
   a. Using the IS-PC-MR model, illustrate and explain how inflation targeting works when there is a change in aggregate demand and agents have adaptive expectations. (15 marks)
   b. Explain how the adjustment would be different, if the central bank only cares about inflation. (10 marks)
   c. Discuss whether an independent central bank should only focus on targeting a specific CPI rate or also take asset prices into account. (5 marks)

Total: 30 marks

End of Section C
End of Paper