STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
BFS 1201: Monetary and financial systems

DATE: Tuesday, 13th April, 2021 **DURATION**: 2 Hours

INSTRUCTIONS:
Answer question one (compulsory) and any other two questions

Question 1 (30 marks)

a) Catherine is a member of Mhudumu Bank. She makes a new deposit of Kshs.100,000 in her checking account. The cash reserve ratio/statutory minimum reserve requirement for all banks is currently set at 5%.

Required:

i. Compute the change in demand deposits on the bank's statement of financial position from this transaction. **(1 mark)**

ii. (b) Suppose that Mhudumu Bank lends out all the excess reserves from Catherine's deposit to John, what will be the amount of the loan? **(2 marks)**

iii. (c) Assume that John deposits the loan proceeds in Mwananchi Bank. The bank loans out all its excess reserves from John's deposit to Peter. What will be the amount loaned out to Peter? **(2 marks)**

b) Briefly explain the impact of commercial banks increasing the lending rates that they charge borrowers on inflation. **(3 marks)**

c) You are provided with Bank A Statement of financial position extract for the financial year 2020/2021 below.

Assets		**Liabilities**	
Reserves	100 million	Demand deposits	350 million
Securities	100 million	Bank capital	50 million
Loans	200 million		
Total	**400 million**		**400 million**

Required:

Compute the Return on Assets (ROA), the equity multiplier and Return on Equity (ROE) if the net profit for the year was 20 million. **(3 marks)**

d) You are provided with the following data for Kenya for the financial year 2019/2020.

Component	**Amount (Billions)**
Currency in circulation	250
Government Borrowing	570
Demand deposits	2000
Imports	945
Residents foreign currency deposits	700
Time deposits	540
Exports	600
Savings deposits	750
Tax revenues	1500

Required:

Compute the monetary aggregates M0,M1,M2 and M3 **(4 marks)**

e) Growth of money supply is vital for the process of economic development and for the achievement of price stability in the economy.Discuss **three** factors that determine the money supply in Kenya and state whether each factor is positively or negatively related to money supply. **(9 marks)**

f) Discuss the **three motives** for holding money according to Keynes in his liquidity preference theory of the demand for real money balances. **(6 marks)**

Question 2 (20 marks)

a) Money can be defined as anything that is generally accepted as payment for goods and services or in the repayment of debts, and is distinct from income and wealth**.** Discuss **three** primary functions of money. **(6 marks)**

b) You are provided with the following data from the CBK annual report FY 2019/2020 .

- ✓ Checkable/ demand deposits=2000 billion
- ✓ Currency in circulation =250 Billion
- ✓ Required reserves = 140 Billion
- ✓ Excess Reserves = 18 Billion

Required:

i. Calculate the value of the currency deposit ratio (c) for the FY 2019/20**.(1 mark)**

ii. Calculate the value of the excess reserve ratio (e) for the FY 2019/20. **(1 mark)**

iii. Given a Cash Reserve Ratio (CRR) of 5% , calculate the value of the money multiplier (m) for the FY 2019/20. **(3 marks)**

iv. What does the money multiplier tell us? **(1 mark)**

c. DTB Bank receives new demand deposits of 5 million in addition to the existing deposits of 20 million. Additionally, the bank has Kshs.700,000 as cash in till and Kshs.1,000,000 as deposits with the Central Bank. This deposits are not yet invested. The current cash reserve requirement (CRR) is 5%.

Required:
Compute the excess reserves of the bank. **(3 marks)**

d. You are provided with the following data for an economy.

Variable	**Kshs. Billion**
Cash in till	47
Banks deposit with the Central Bank	155
Currency in circulation	210
Excess reserves	16
Demand deposits	2,000
Savings deposits	750

Required:

i. Compute the total bank reserves. **(2 marks)**

ii. Compute the level of monetary base. **(1 mark)**

iii. Calculate the level of money supply as measured by monetary aggregate M2. **(2 marks)**

Question 3 (20 marks)

a) List and explain **two** advantages and **two** disadvantages of inflation targeting as a monetary policy strategy. **(4 marks)**

b) Central banks are national authorities that conducts monetary policy, regulate banks and provides financial services. Discuss **four** main goals of central banks in their conduct of monetary policy. **(8 marks)**

c) To influence the money supply and interest rates, the Central Bank of Kenya employs various monetary policy tools. Explain how the Central Bank uses reserve requirements, open market operations and the Central bank rate to conduct monetary policy.

(8 marks)

Question 4 (20 marks)

a) Differentiate the following policies: Expansionary and contractionary fiscal policies.

: Expansionary and contractionary monetary policies.

(4 marks)

b) Explain **three** ways in which fiscal policy impacts on businesses. **(6 marks)**

c) Briefly describe the connection between financial markets and economic growth.

(2 marks)

d) Discuss **four** principles of bank management that are primary concerns of bank managers. **(8 marks)**

Question 5 (20 marks)

a) List and explain **four** factors that can shift the IS curve to a new position and discuss the effect of an increase in each factor on the curve . **(8 marks)**

b) Explain **four** factors that determine money demand according to the portfolio theories of money demand. State whether an increase or decrease in each factor can increase the demand for money. **(8 marks)**

c) You are provided with data below for money supply (M) and the annual nominal Gross Domestic Product (PY) for an economy for four years.

:P is the price level and Y is aggregate output (income).

	2017 (Billion)	**2018 (Billion)**	**2019(Billion)**	**2020 (Billion)**
M	190	200	210	220.5
PY	1,800	2,000	2,200	2,420

Required:

i. In accordance with the quantity theory of money demand compute the velocity of money for each year. **(4 marks)**