GX346

OLLSCOIL NA hÉIREANN
NATIONAL UNIVERSITY OF IRELAND, GALWAY

SUMMER EXAMINATIONS 1999

MONETARY ECONOMICS II (EC 321)

THIRD ARTS, THIRD COMMERCE AND VISITING STUDENTS

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Time allowed: TWO hours
Please answer SIX questions from Part A and TWO questions from Part B. The two parts are equally weighted.

PART A

1. Explain the announcement effect of discount loan policy. When is this effect subject to misinterpretation ? How can misinterpretation be avoided ?

2. Edward Kane of Boston College has claimed that all banking regulation is endogenous. Explain using the framework of the regulatory dialectic. Explain how the US regulation of deposit interest rate ceilings fits in this framework.

3. Why is the EU's Second Banking Directive more likely to lead to increasing deregulation in the European retail banking industry than the first Banking Directive ?

4. Discuss the necessary criteria for choosing intermediate targets in the implementation of monetary policy.

5. Explain verbally the optimisation problem faced by individuals in the Baumol-Tobin model of the transactions demand for money. State the determinants of money demand according to this model.

6. Explain whether and how the development of the Federal Funds market would affect the size of monetary base and money supply.

7. Explain the arguments in favour of the imposition of bank minimum capital requirements.

8. Explain how transactions costs can justify the role of financial intermediaries in modern financial systems.

PART B

1. (a) Compare and contrast the following three theories of money demand: (i) the Keynesian liquidity preference theory, (ii) Tobin's speculative money demand theory and (iii) Friedman's modern version of the Quantity theory of money. In your answer include the following areas (17 pts):

p.t.o.

(i) The determinants of money demand
(ii) the number of assets considered
(iii) the consideration of the return on money
(iv) the variability of money demand
(v) the predictability of velocity

(b) Derive the money demand function of the Baumol-Tobin model of the transactions demand for money. (8 pts)

2. (a) Explain the adverse selection problem in the securities market and discuss alternative proposals for its solution. (9 pts)

(b) Explain all the factors that can lead to a financial crisis. (9 pts)

(c) Explain financial repression as a mechanism accounting for low income growth rates in several developing countries. (7 pts)

3. (a) Compare and contrast the M1 and M2 multipliers. How do they compare with the simple deposit multiplier ? (6 pts)

(b) Will inflation have a smaller or a larger effect on the currency/checking deposit ratio if income tax rates are indexed to the inflation rate? (7 pts)

(c) Suppose that the Fed decides to pay interest on bank excess reserves. Would this policy have any effect on the money supply and the monetary base ? Would this policy enhance the Fed's control over the money supply ? Explain. (7 pts)

(d) Explain the impact of the Great Depression on US monetary base and the money supply. (5 pts)

4. (a) Explain the factors that led to the U.S. banking crisis of the 1980s. What were the reasons for the persistence of the crisis ? In your opinion, are the proposals introduced to reform the U.S. banking system adequate ? (17 pts)

(b) Discuss how economic barriers to entry can explain the lack of contestability in retail banking markets in post-1992 Europe. (8 pts)