

2805/301

MONETARY AND FINANCIAL SYSTEMS

March/April 2025

Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN BANKING AND FINANCE

MONETARY AND FINANCIAL SYSTEMS

3 hours

## INSTRUCTIONS TO CANDIDATES

*This paper consists of SEVEN questions.**Answer any FIVE questions in the answer booklet provided.**All questions carry equal marks.**Candidates should answer the questions in English.***This paper consists of 2 printed pages.****Candidates should check the question paper to ascertain that both pages are printed as indicated and that no questions are missing.**

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**Turn over**

1. ✓ (a) Explain five negative effects of high inflation rate in the economy. (10 marks)
- (b) Outline five reasons that make it necessary to regulate the financial sector in a country. (10 marks)  
 ✓ Increased borrowing costs ✓ Sector imbalances  
 ✓ Currency fluctuations ✓ Investment uncertainty  
 ✓ Reduced consumer spending
2. ✓ (a) (i) Explain three factors that determine the percentage of liquidity held by commercial banks. (6 marks)  
 ✓ Price stability  
 ✓ Political stability  
 ✓ Market conditions
- (ii) Outline three components of liquid assets in a commercial bank. (6 marks)
- (b) Explain four benefits that may accrue to a company from using debt finance. (8 marks)  
 ✓ Trade policies ✓ Political stability  
 ✓ Inflation rates ✓ Availability of capital  
 ✓ Increase of standards of living
3. (a) Devaluation of currency is one of the methods a country may adopt to correct a balance of payment deficit. Outline five appropriate conditions necessary for adopting such method. (10 marks)
- (b) In relation to interest rates: (2 marks)
- (i) Distinguish between nominal and real interest rates. (2 marks)
- (ii) Outline four effects of a high level of real interest rate in a country. (8 marks)
4. ✓ (a) One of the instruments that may be used to control the supply of money in an economy is monetary policy. Explain five tools that may be used in such policy to increase the supply of money. (10 marks)  
 ✓ Open market operations ✓ Liquidity ratios  
 ✓ Directives ✓ Reserve requirements  
 ✓ Morals
- (b) Outline five limitations of using index numbers in measuring the value of money. (10 marks)  
 ✓ Lack of calculation ✓ No time value of money  
 ✓ It is expensive to measure ✓ Lack of regulation  
 ✓ High inflation rate ✓ It leads to cyber attack ✓ It is tied to a lack in inherent value
5. ✓ (a) Explain five benefits of establishing a strong securities exchange market in a country. (10 marks)
- (b) Outline five advantages a country may derive from using a fixed exchange rate system. (10 marks)  
 ✓ Stability & predictability ✓ Trade promotion → By providing  
 ✓ Controlled inflation → maintaining value of ✓ External stability → By reducing attacks  
 ✓ Monetary discipline → maintenance
6. ✓ (a) Highlight five effects of changes of a country's money stock on commercial banks. (10 marks)
- (b) Explain five risk management techniques that corporates may adopt when carrying out their operations. (10 marks)  
 ✓ Liquidity risk ✓ Exchange rate risk  
 ✓ Political risk ✓ Interest rate risk  
 ✓ Credit risk ✓ Market risk
7. (a) Explain five ways in which financial intermediation between lenders and ultimate borrowers may be structured to minimise losses of defaults. (10 marks)
- (b) Highlight five challenges that monetary authorities may face in maintaining equilibrium in the market. (10 marks)

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