UNIVERSITY   OF SWAZILAND

FACULTY OF SOCIAL SCIENCE

DEPARTMENT OF ECONOMICS

MAIN EXAMINATION

MAY 2013

TITLE OF PAPER: INTERMEDIATE MACROECONOMIC THEORY

COURSE CODE: ECON 304

TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS: 1.   ANSWER FOUR (4) QUESTIONS:

2.   ALL QUESTIONS CARRY 25 MARKS EACH

THIS PAPER IS NOT SUPPOSED TO BE OPENED UNTIL PERMISSION
HAS BEEN GRANTED BY THE INVIGILATOR

QUESTION 1

Write short explanatory notes on the following: **(5 marks each)**

a) Rational Expectations school of thought.

b) The government of Swaziland is currently experiencing a crisis in its fiscal policy. It has been reported in the newspapers that expenditure far exceeds the revenue available. The minister of finance has hinted that his government would borrow domestically in order to finance this huge deficit. As an economist advice the minister on the likely problems the economy would face if he only relies on this particular type of deficit financing.

c) Net Exports.

d) Natural rate of unemployment.

e) Business Cycles.

QUESTION 2

a) Outline the instruments for controlling money supply in an economy.   **(6)**

b) Discuss the effectiveness of monetary policy in the extreme case of a vertical LM curve

(10)

c) Discuss the effectiveness of fiscal policy in the extreme case of a horizontal LM curve.

(9)

QUESTION 3

a)   Derive the balance of payments curve graphically. What influences its slope? What factors can cause it to move upwards or downwards (shift)?   **(15)**

b)   Outline the effectiveness of an expansionary fiscal policy with immobile capital under a flexible exchange rate regime.   **(10)**

QUESTION 4

a) Compare and contrast the macroeconomic views of the Monetarist and Keynesian schools of thought. **(15)**

b) Another macroeconomic school of thought that emanated in the 1970's following the monetarist school of thought is the Rational Expectations school. Provide an outline of the main arguments for this school of thought. **(10)**

QUESTION 5

a) Write short explanatory notes on the following concepts: **(3marks each)**

    i) Efficiency wage models

    ii) Inflationary gap

    iii) Natural rate of unemployment

b) The Swaziland Federation of Trade Union (SFTU) and Swaziland Federation of laborers (SFL) in their wage negotiations with their employers managed to attain a bargained real wage represented by the following function: $W/P_e = m_0 + m_1 Y$. Let us assume that these unions were basing their wage negotiations on adaptive expectations so that they expect the price level to be constant over time i.e. $P_e = P_{-1}$. Given that the price that firms set after taking into account the bargained real wage is represented by

$$P = (1-b)W, \text{ where b is the mark-up:}$$

i) Derive the aggregate supply equation for the Swazi economy using the information provided above and also graph the aggregate supply curve. **(10)**

ii) What are the properties of the aggregate supply curve you derived in (i) **(6)**

GOOD LUCK!!GOOD LUCK!!!