

**UNIVERSITY OF SWAZILAND
FACULTY OF SOCIAL SCIENCE
DEPARTMENT OF ECONOMICS**

MAIN EXAMINATION

MAY 2015

TITLE OF PAPER: INTERMEDIATE MACROECONOMIC THEORY

COURSE CODE: ECON 304

TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS: 1. ANSWER FOUR (4) QUESTIONS:

QUESTION ONE (1) IS COMPULSORY AND YOU CAN THEN CHOOSE ANY THREE (3) QUESTIONS FROM THE REMAINING QUESTIONS PROVIDED.

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 (Compulsory)

- a) Consider a closed economy where consumption is given by the equation $C = 700 + \frac{1}{2}(Y - T)$. Planned investment is $I = 500 - 50i$; $G = 500$ and $T = 400$.
- i) Find the equilibrium level of Y when $i = 6\%$. (6)
 - ii) Does $S = I$? verify (4)
- b)
- i) Assume that i is still fixed at $i = 6\%$ as in a) and G increases by 100, What is the new equilibrium value of Y ? (4)
 - ii) In an IS-LM setting where i is not fixed, would the increase in G increase or decrease i ? (6)
 - iii) What effect would the change in i have on investment? (3)
 - iv) What is the name of the phenomenon you described in iii). (2)
- c) Outline the main instruments or tools of monetary policy that the central bank uses to control money supply in the economy? (6)

Question 2

- a) Differentiate between the balance of payments and the balance of trade. (5)
- b) Compare and contrast the macroeconomic views suggested by the monetarist school of thought to that of the Keynesian school. (20)

Question 3

- a) The government of Swaziland is currently experiencing a crisis in its fiscal policy. It has been reported in newspapers that expenditure far exceeds the revenue available. The minister of finance has hinted that his government would borrow domestically (from the private sector and draw down reserves from the central bank) in order to finance this huge deficit. As an economist advise the minister on the likely problems the economy would face if he only relies on this particular type of deficit financing. (6)
- b) Due to the current financial crises affecting Swaziland, the members of parliament have voted for a fiscal stimulus to overcome the crises. Explain using the IS-LM model how the desired objective will be achieved. (6)

- c) In the Times of Swaziland dated 13th March, 2015, it was reported that the Lilangeni hit an all time low rate of E13 against the US Dollar. As an economist discuss how this exchange rate will affect the economy. (7)
- d) Differentiate between Irvin Fisher's equation and the equation of exchange. (6)

Question 4

- a) Consider a small open economy operating under a fixed exchange rate regime. Assume that in this economy capital is perfectly mobile. Describe how the internal and external equilibrium of the economy will be determined if the economy undertakes an expansionary monetary policy. Illustrate your answer with the aid of a diagram. (12)
- b) Derive the balance of payments curve. What influences its slope? What factors can cause it to move upwards or downwards (shift)? (13)

Question 5

- a) Write short explanatory notes on the following concepts:

- i) Efficiency wage models (3)
- ii) Inflationary gap (3)
- iii) Natural rate of unemployment (3)

b) The Swaziland Federation of Trade Union (SFTU) and Swaziland Federation of labors (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

$P = (1-b)W$, 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)