UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

MAIN EXAMINATION 2014/2015

TITLE OF PAPER	:	INTERNATIONAL FINANCE
COURSE CODE	:	ECON 407
TIME ALLOWED	:	THREE (3) HOURS

INSTRUCTIONS :

1. QUESTION ONE (1) IS COMPULSORY
2. ANSWER ANY OTHER TWO (2) QUESTIONS IN SECTION B

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

SECTION A

QUESTION 1 (COMPULSORY)

With the aid of an example distinguish between:

a) Fixed Exchange Rates versus Flexible Exchange Rates
b) Covered Interest Parity (CIP) and Uncovered Interest Parity (UIP) (state formulas for full marks)
c) Nominal Exchange Rate and the Real Exchange Rate
d) The Law of One Price and Relative Purchasing Power Parity

[5 Marks Each]

SECTION B (ANSWER ONLY TWO (2) QUESTIONS FROM THIS SECTION)

QUESTION 2

a) Why should Interest Rate Parity hold for the exchange rate market to be in equilibrium? [10 Marks]
b) Using an appropriate graph explain fully the channel of how a decrease in the interest rate in Nigeria (foreign country) affects the exchange rate with its major trading partner Swaziland (home country). [15 marks]
c) Money markets between countries can be linked through the exchange rate market. Graphically illustrate and explain the effect of a decrease in the money supply of the home country on the exchange rate. [15 Marks]

QUESTION 3

a) Using appropriate graphs for both the short run and the long run, illustrate and explain the effects of a permanent increase in the home country's money supply on the exchange rate (Make sure to bring in the issue of exchange rate overshooting).

[15 Marks]

b) Assuming that Purchasing Power Parity (PPP) holds, derive the equation for exchange rate determination under the Monetary Approach. [15 Marks]

c) The monetary approach gives a different result to the effect of interest rates on exchange rates than the prediction without PPP. Explain why this paradox exists. [10 Marks]

QUESTION 4

a) Explain how an increase in the Real Exchange Rate affects exports and imports? [15 Marks]

b) Discuss the **volume effect** and the **value effect** with regards to how the current account will move with regards to a change in the real exchange rate. [10 Marks]

c) Graphically illustrate and explain the effect of contractionary monetary policy on the current account in the short run. [15 Marks]