UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

MAIN EXAMINATION 2016/2017

TITLE OF PAPER : INTERNATIONAL FINANCE

COURSE CODE : ECON 407

TIME ALLOWED : THREE (3) HOURS

INSTRUCTIONS :

1. QUESTION ONE (1) IN SECTION A IS COMPULSORY AND IT CARRIES 40 MARKS
2. ANSWER ANY OTHER TWO (2) QUESTIONS IN SECTION B. ALL QUESTIONS IN SECTION B CARRY 30 MARKS EACH.
3. ONLY SCIENTIFIC NON-PROGRAMMABLE CALCULATORS ARE ALLOWED.
4. ROUND UP YOUR FINAL ANSWERS TO TWO (2) DECIMAL PLACES.

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

SECTION A

QUESTION 1 (COMPULSORY) [40 Marks]

a) Distinguish between an appreciation and a depreciation of a currency. [6 Marks]

b) Explain how each of the following transactions generates two entries, a credit and a debit, in Swaziland's Balance of Payments accounts, at a spot rate of $E18/£1$. Also describe which category of the BoP account will be used to record them:

i. A Swazi citizen acquires $£1,000$ in foreign currency to enable her to purchase some goods from the United Kingdom (UK). [5 Marks]

ii. The Swazi individual purchases a Samsung smartphone from the UK worth $£550$. [5 Marks]

iii. An icing sugar packaging company in the UK purchases sugar from the Swaziland Sugar Association worth $E12{,}500$. [5 Marks]

c) If the Naira-Lilangeni exchange rate is $NGN25/E1$ and the Lilangeni-Pound Sterling exchange rate is $E19/£1$, what would be the Naira-Pound Sterling exchange rate? [6 Marks]

d)

i. State the interest parity condition. [3 Marks]

ii. Assume the interest rate in Swaziland is 10% and it is 3% in the France. Furthermore, the spot exchange rate is $E13.5/€1$ and the expected future rate is $E14.75/€1$. If a Swazi individual has $E5000$, state where they would invest their money. Generalise your conclusion for the entire market of investors in the two (2) countries to come up with a spot exchange rate that will bring the foreign exchange market to equilibrium. [10 Marks]

SECTION B

Answer any Two (2) Questions from this Section

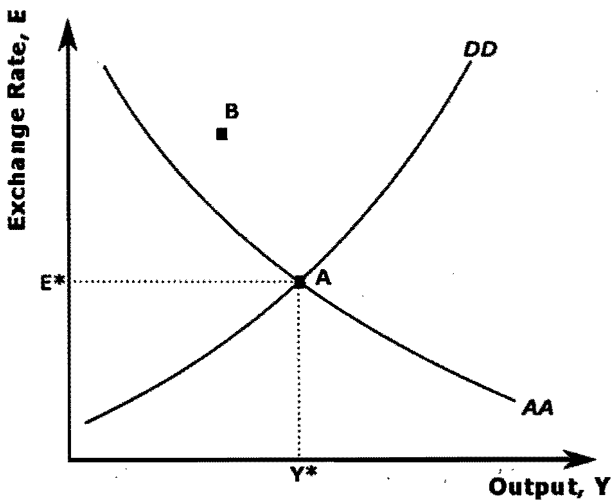
QUESTION 2 [30 Marks]

a) Money markets between countries can be linked through the exchange rate market. Graphically illustrate and explain the effect of an **increase** in the money supply of the home country on the exchange rate in the short run (price level fixed). [20 Marks]

b) Assuming that Purchasing Power Parity (PPP) holds, derive the equation for exchange rate determination under the Monetary Approach. [10 Marks]

QUESTION 3 [30 Marks]

a) The $AA - DD$ framework links output and the exchange rate as depicted in the figure below. The equilibrium at point A is said to be a stable equilibrium. Graphically illustrate and fully explain how this equilibrium can be achieved from point B. [20 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]

QUESTION 4 [30 Marks]

a) Graphically illustrate and explain the effect of a **contractionary** monetary policy on the current account [15 Marks]

b) The Fischer Effect utilises the Uncovered Interest Parity Condition $\left(R_{\$} = R_{€} + \left(E^{e}{}_{\$/€} - E_{\$/€}\right)/E_{\$/€}\right)$ and Relative Purchasing Power Parity $\left(\frac{E_{\$/€,t} - E_{\$/€,t-1}}{E_{\$/€,t-1}}\right)$. From this information, derive the Fischer equation and interpret it regarding it's implication on economic variables. [15 Marks]