UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

MAIN EXAMINATION 2017/2018

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) With the aid of an example distinguish between:

  i. Depreciation versus a Devaluation [5 Marks]

  ii. Foreign Exchange Futures versus Foreign Exchange Option [5 Marks]

b) If the Nigerian Naira – Lilangeni exchange rate is $NGN35/E1$ and the Lilangeni – Japanese Yen exchange rate is $E0.11167/JPY1$, what would be the JPY-NGN exchange rate? [6 Marks]

c) Assume the interest rate in Swaziland is 7% and it is 4% in the Germany. Furthermore, the spot exchange rate is $E13.5/€1$ and the expected future rate is $E14/€1$. If a Swazi individual has $E10{,}000$, 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. [8 Marks]

d) State and explain the Fischer Equation and explain what it means. [8 Marks]

e) Describe the effects of an unexpected devaluation on the Central Bank's balance sheet and on the balance of payments accounts [8 marks]

SECTION B - Answer any Two Questions from this Section

QUESTION 2 [30 Marks]

a) Using appropriate graphs for both the short run and the long run, illustrate and explain the effects of a permanent **decrease** in the home country's money supply on the exchange rate (Make sure to bring in the issue of exchange rate overshooting). [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) Using an appropriate graph explain fully the channel of how an increase in the interest rate in China (foreign country) affects the exchange rate with its major trading partner Swaziland (home country). [15 marks]

b) 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 (fixed prices). [15 Marks]

QUESTION 4

a) Differentiate between internal and external balance. [5 Marks]

b) Explain and give examples of the difference between an expenditure changing policy and an expenditure switching policy. [10 Marks]

c) Using the II-XX framework, illustrate and explain that fiscal policies by themselves cannot bring the economy to internal and external balance. [15 Marks]