UNIVERSITY OF ESWATINI

SECOND SEMESTER MAIN EXAMINATION PAPER, AUGUST 2020

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO 402/ ECON 404

TITLE OF PAPER: MONETARY POLICY

TIME ALLOWED: 2 HOURS

Instructions

1. This paper consists of Section (A) and (B).
2. Section A is compulsory.
3. Answer any two questions from Section B.

Special Requirements

Scientific calculator

Candidates may complete the front cover of their answer book when instructed by the Chief Invigilator and sign their examination attendance cards but must NOT write anything else until the start of the examination period is announced.

No electronic devices capable of storing and retrieving text, including electronic dictionaries and any form of foreign material may be used while in the examination room.

DO NOT turn examination paper over until instructed to do so.

SECTION A

QUESTION ONE: COMPULSORY **[40 Marks]**

1. (a) At its MPC meeting held On the 20th of March 2020, the Central Bank of Eswatini decided to reduce the discount rate by 100 basis points to 5.5%.

(i) What are the other measures the CBE implemented to support the economy? [5]

(ii) What was the intended impact of these measures on aggregate output? Motivate your answer by discussing the monetary transmission mechanism through the bank lending channel. Be sure to state the assumptions behind the credit rationing mechanism. [14]

(b) What role should domestic monetary policy play in the maintenance of financial stability? [3]

(c) With the aid of a diagram, illustrate the effect of expansionary fiscal policy in a small open economy with imperfect capital mobility. [18]

SECTION B

ANSWER ANY TWO (2) QUESTIONS **[30 Marks Each]**

Question Two **(30 Marks)**

2. (a) Why do bank panics worsen asymmetric information problems in credit markets?[14]

(b) Explain how monetary policy can still be effective in an environment with zero-bound interest rates. [10]

(c) Briefly explain why the transmission of monetary policy is often difficult in developing and transitional economies. [6]

Question Three **(30 Marks)**

3. (a) Discuss the key advantages of exchange-rate targeting as a monetary policy strategy for the Central Bank of Eswatini. [12]

(b) Discuss the key disadvantages of exchange-rate targeting. [12]

(c) When is exchange-rate targeting likely to be a sensible strategy for developing countries? [6]

Question Four **(30 Marks)**

4. (a) "If a small open country wants to keep its exchange rate from changing, it must give up some control over its money supply." Is this statement true, false, or uncertain? Explain your answer. [15]

(b) What are the advantages and disadvantages of having the IMF as an international lender of last resort? [15]