



UNIVERSITY OF ESWATINI

SECOND SEMESTER RE-SIT/ SUPPLEMENTARY EXAMINATION

PAPER, JULY 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)(i) Describe how the exchange rate channel of monetary policy affects output and prices in the short run. [10]
- (ii) Assuming sticky prices in the long run, how would a nominal depreciation affect prices, aggregate demand and aggregate supply? [7]
- (b) In your opinion, is the channel in (a) above an effective transmission mechanism in Eswatini? Give reasons to support your answer. [3]
- (c) (i) With the aid of a diagram, discuss the Impossible Trinity Principle [15]
- (ii) What is the implication of the Impossible Trinity Principle on the conduct of monetary policy for the Central Bank of Eswatini? [5]

SECTION B

ANSWER ANY TWO (2) QUESTIONS

[30 Marks Each]

Question Two

(30 Marks)

- 2.(a) (i) Which policy tool can the central bank use to control the three-month Treasury bill rate? Describe how the interest rate target is maintained using this particular policy tool. [8]
- (ii) With the aid of a diagram, explain why the control of this interest rate implies that the central bank cannot target the money supply? [10]
- (b) Discuss the pros and cons of inflation targeting in the context of a particular economy that follows the regime. [12]

Question Three

(30 Marks)

3. (a) Identify and briefly explain the various policies that a nation could adopt to correct a deficit in the balance-of-payments under a fixed exchange rate system. [14]

(b) Explain why it is important that there is coordination when setting the objectives of both fiscal and monetary policy. Give any four examples to support your answer. [16]

Question Four

(30 Marks)

4. (a) With the aid of a diagram, explain what would be the impact of a reduction in the tax rate if we have an economy without capital mobility and fixed exchange rates? [15]

(b) With the aid of a diagram, explain what should be done once the central bank was unable to run an active monetary policy and the government would like to keep fixed exchange rates? [15]