

UNIVERSITY OF ESWATINI

SECOND SEMESTER MAIN EXAMINATION PAPER, AUGUST 2020

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO404 / ECON407

TITLE OF PAPER: INTERNATIONAL TRADE II

TIME ALLOWED: 2 HOURS

Instructions

1. This paper consists of two Sections, (A) and (B).
2. Question 1 in Section A is compulsory.
3. Choose any two (2) questions in Section B
4. Where there are calculations involved, round up your final answer to two (2) decimal places.

Special Requirements

Scientific calculator

Additional Material (s)

None

*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 1 (COMPULSORY)

[40 Marks]

- a) With the aid of an example distinguish between:
- Depreciation versus a Devaluation [5 Marks]
 - 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

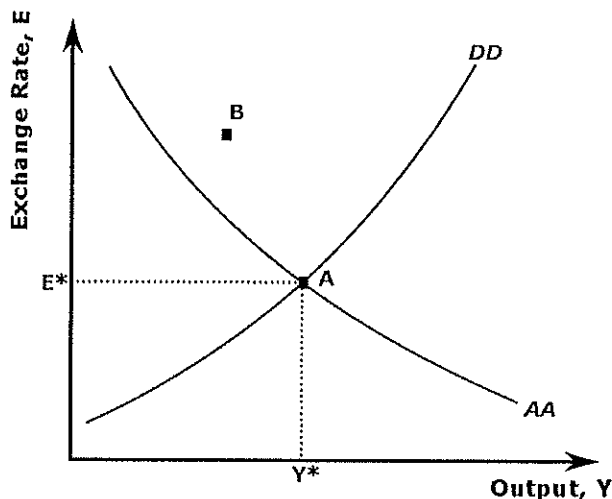
[30 Marks]

- a) 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 ($R_{\$} = R_{\epsilon} + (E_{\$/\epsilon}^e - E_{\$/\epsilon}) / E_{\$/\epsilon}$) and Relative Purchasing Power Parity ($\frac{E_{\$/\epsilon,t} - E_{\$/\epsilon,t-1}}{E_{\$/\epsilon,t-1}}$). From this information, derive the Fischer equation and interpret it regarding its implication on economic variables. [15 Marks]