



# UNIVERSITY OF ESWATINI

SECOND SEMESTER RESIT EXAMINATION PAPER, JULY 2020

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO404 / ECON407

TITLE OF PAPER: INTERNATIONAL TRADE II

TIME ALLOWED: 2 HOURS

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## 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) 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:
- A Swazi citizen acquires  $£1,000$  in foreign currency to enable her to purchase some goods from the United Kingdom (UK). [5 Marks]
  - The Swazi individual purchases a Samsung smartphone from the UK worth  $£550$ . [5 Marks]
  - 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  $NGN25/£1$  and the Lilangeni-Pound Sterling exchange rate is  $E19/£1$ , what would be the Naira-Pound Sterling exchange rate? [6 Marks]
- State the interest parity condition. [3 Marks]
  - 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) 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). [10 Marks]
- b) Assuming that Purchasing Power Parity (PPP) holds, derive the equation for exchange rate determination under the Monetary Approach. [10 Marks]
- c) The monetary approach gives a different result to the effect of interest rates on exchange rates than the prediction without PPP. Explain why this paradox exists. [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. [15 Marks]

**QUESTION 4**

- a) Graphically illustrate and explain the effect of an **expansionary** 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  $\left(\frac{E_{\$/\epsilon,t} - E_{\$/\epsilon,t-1}}{E_{\$/\epsilon,t-1}}\right)$ . From this information, derive the Fischer equation and interpret it regarding its implication on economic variables. [15 Marks]