

UNIVERSITY OF ESWATINI

SECOND SEMESTER MAIN EXAMINATION PAPER, NOVEMBER
2021

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO404

TITLE OF PAPER: INTERNATIONAL TRADE II

TIME ALLOWED: 2 HOURS

Instructions

1. This paper consists of Two Sections (A) and (B). Question One (1) in section A is compulsory and it carries Forty (40) Marks
2. Answer any two (2) questions in 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 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 Eswatini's Balance of Payments accounts, at a spot rate of $E20/£1$. Also describe which category of the BoP account will be used to record them:
- i. A Swazi citizen acquires $£1,000$ in foreign currency to enable her to purchase some goods from the United Kingdom (UK). [5 Marks]
 - ii. The Swazi individual purchases a Samsung smartphone from the UK worth $£550$. [5 Marks]
 - iii. 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 $NGN30/E1$ and the Lilangeni-Pound Sterling exchange rate is $E20/£1$, what would be the Naira-Pound Sterling exchange rate? [6 Marks]
- d)
- i. State the interest parity condition. [3 Marks]
 - ii. Assume the interest rate in Eswatini is 10% and it is 5% in the France. Furthermore, the spot exchange rate is $E15/€1$ and the expected future rate is $E17/€1$. 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

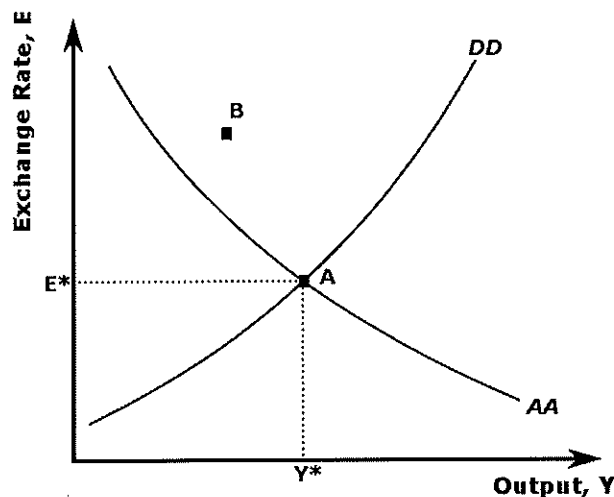
[30 Marks]

- a) 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, which is:

$$(R_{\$} = R_{\text{€}} + (E_{\$/\text{€}}^e - E_{\$/\text{€}}) / E_{\$/\text{€}}) \text{ and Relative Purchasing Power Parity } \left(\frac{E_{\$/\text{€},t} - E_{\$/\text{€},t-1}}{E_{\$/\text{€},t-1}} \right).$$

From this information, derive the Fischer equation and interpret it regarding its implication on economic variables. [15 Marks]