UNIVERSITY OF JOHANNESBURG

**FACULTY OF MANAGEMENT**
**LAST ASSESSMENT OPPORTUNITY**

**DEPARTMENT OF BUSINESS MANAGEMENT**

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| **MODULE:** | **APPLIED MACROECONOMICS** |
| **CODE:** | **BMA9X03** |
| **DATE:** | **10 JUNE 2014** |
| **DURATION:** | **3 HOURS** |
| **TIME:** | **12:30 to 15:30** |
| **TOTAL MARKS:** | **100** |

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| **EXAMINER:** | **PROF S CHETTY** |
| **EXTERNAL MODERATOR:** | **MS A PRETORIUS** |
| **NUMBER OF PAGES:** | **2** |

**INSTRUCTIONS TO CANDIDATES**

1. There are 4 questions. **Answer question 1 (compulsory) plus 2 other questions. (In total you must answer 3 questions)**
2. Number your answers correctly as per the question paper and in your own interest, please write legibly.

**NOTE: THIS IS A CLOSED BOOK ASSESSMENT**

**QUESTION 1 (This question is compulsory)** **[40]**

Earlier this year, the rand exhibited extreme volatility against key foreign currencies. This high volatility was experienced in 2013 and is expected to continue through 2014. Just before the end of October 2013, the rand traded at just under R10,00 to the dollar. By 24 January 2014, it pushed above R11,00 to the dollar. By the end of March 2014, it was trading at R10,54 to the dollar. The rand remains a fragile currency. The extreme rand volatility raised concerns at the South African Reserve Bank (SARB), prompting an interest rate increase in January 2014 for the first time in almost six years. Even though it left the interest rate unchanged at its March 2014 meeting, the Monetary Policy Committee of the SARB has indicated a tighter monetary policy stance going forward. Against this background, answer the following questions:

1.1 Fluctuating exchange rates are characteristic of a flexible (floating) exchange rate system, as is currently followedby South Africa. With the use of an appropriate diagram depicting the rand-dollar exchange rate, explain fully the workings of a **flexible exchange rate system**. (8)

1.2. Discuss **TWOimplications** of exchange rate volatility for private business. (6)

1.3 In his Budget Speech, earlier this year, the Minister of Finance said that "The rand remains an effective shock absorber against global volatility." In this context, explain how a weakening rand can **benefit** the South African economy. (4)

1.4 Explain the **inflationary risk** of a weakening rand to the South African economy. (4)

1.5 With the use of the aggregate demand and supply model, discuss and illustrate the effect of a significant **depreciation (weakening) in the external value of the rand** on the South African economy **through the SUPPLY SIDE (aggregate supply)**. Start from a position of less than full employment. (12)

1.6 Explain **TWOreasons** for the increased volatility of the rand exchange ratesince the latter part of 2013. (6)

**QUESTION 2** **[30]**

South Africa's unemployment rate in the 4th quarter of 2013 stood at 24,1 percent. Formal sector employment increased by 38 000 from 8 457 000 to 8 495 000 from the 3rd quarter to the 4th quarter. CPI inflation in February 2014, was recorded at 5,9 percent year on year. South Africa aims to achieve both low unemployment and price stability. In light of this, answer the following questions:

2.1 Briefly explain the following concepts:

- Structural unemployment (3)
- Cost-push inflation (3)

2.2 Make use of the **Phillips curve** to discuss why South Africa's aim of low unemployment and low inflation (price stability) can present a **policy dilemma** to policy makers. (10)

2.3 Explain **TWO advantages** of South Africa's policy of **inflation targeting**. (6)

2.4 South Africa's National Development Plan aims to reduce unemployment to 14% by 2020 and to 6% by 2030. This implies the need to create 11 million new jobs. Discuss **TWO key challenges** that would need to be overcome towards achieving this goal. (8)

**QUESTION 3** **[30]**

3.1 Explain the concept of **economic growth** and its calculation. (5)

3.2 Distinguish between **monetary and fiscal** policy. (4)

3.3 Distinguish between the concepts of **conventional and primary budget deficits**. (4)

3.4 Explain the concept of **public debt**. (2)

3.5 Make use of the**Keynesian paradigm** to critically evaluate the effectiveness of the **budget deficit** in stimulating economic growth in South Africa. (6)

3.6 Explain **THREE implications** of the South African 2013/14 **national budget** for private business. (9)

**QUESTION 4** **[30]**

4.1 Explain the following:

- The **real interest rate** including the **Fisher effect** (4)
- The relationship between **bond prices and yields** (4)

4.2 With the use of a diagram depicting the investment (capital formation) curve, explain the impact of an **increase in fixed investor uncertainty**, and explain **THREE factors** that currently may (or have the potential) to contribute to **negative fixed investor sentiment** in South Africa. (13)

4.3 Discuss **THREE** implications of **rising interest rates** for private businesses. (9)