



**FACULTY OF MANAGEMENT
SUPPLEMENTARY LAST ASSESSMENT OPPORTUNITY**

DEPARTMENT OF BUSINESS MANAGEMENT

MODULE:	APPLIED MACROECONOMICS
CODE:	BMA9X03
DATE:	27 JULY 2016
DURATION:	3 HOURS
TOTAL MARKS:	100

EXAMINER:	PROF S CHETTY
EXTERNAL MODERATOR:	PROF D BLAAUW
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]

Price stability is an important macroeconomic goal. To this end, South Africa follows a strategy of inflation targeting, which entails a policy of maintaining the inflation rate within a predetermined band. In recent months, price stability in the country has come under serious threat, which has seen the upper end of the targeted range being breached in early 2016, with inflation recorded at 6.2% in January and 7% in February (year on year). This has prompted a particular course of policy action in an attempt to rein in the inflation rate. The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) increased the repo rate (benchmark interest rate) by 25 basis points in March 2016 to 7%, following two previous hikes. Further hikes are expected. Given this background, answer the following questions:

- 1.1 Explain the objective of inflation targeting and discuss the importance of central bank independence for the success of an inflation targeting policy in a South African context. (7)
- 1.2 Discuss **THREE** factors which currently contribute to inflationary pressure in South Africa. (12)
- 1.3 Suppose the monetary policy authorities continue with a **series** of interest rate hikes to address inflationary pressure in the country. Analyse the potential effects of this policy action on the economy from the demand side with the use of the aggregate demand and supply model. In your analysis, assume an initial position of less than full employment equilibrium. (12)
- 1.4 Explain **THREE** implications of interest rate hikes for private business. (9)

QUESTION 2

[30]

- 2.1 Discuss the concept of structural unemployment and its prevalence in South Africa. (9)
- 2.2 Explain the concept of 'jobless economic growth' in a South African context. (4)
- 2.3 Provide an evaluation of South Africa's economic growth outlook for 2016 and 2017. Ensure that you substantiate your view, with clearly articulated reasons. (12)
- 2.4 Briefly explain the meaning of fixed capital formation (investment) and its relevance for the performance of an economy. (5)

QUESTION 3

[30]

- 3.1 Discuss the economic meaning and interpretation of the real exchange rate. (6)
- 3.2 Significant volatility has been experienced over several months in the value of the South African Rand against major foreign currencies. In light of this, answer the following:
 - 3.2.1 Explain **TWO** reasons for the increased volatility of the Rand on the foreign exchange market. (6)
 - 3.2.2 Explain **TWO** implications of such volatility for private business in South Africa. (6)
- 3.3 With the aid of a diagram depicting the foreign exchange market for American dollars in terms of the South African Rand, evaluate the effect of an increase in the demand for dollars under a flexible/floating exchange rate system. (6)
- 3.4 Explain **TWO** policy options that South Africa could follow to address balance of payments problems arising from adverse capital shocks. (6)

QUESTION 4

[30]

- 4.1 Distinguish broadly between the Keynesian and Neoclassical views on the ability of an economy to attain/maintain full employment equilibrium and the implications for active aggregate demand management policies. (6)
- 4.2 Make use of the Ricardian Equivalence paradigm to evaluate whether budget deficits are good or bad for economic growth. (6)
- 4.3 Explain how an analysis of the variables, public debt and GDP, can be undertaken to assess fiscal sustainability and thereafter, make use of the same variables, to provide an evaluation of South Africa's current fiscal state. (10)
- 4.4 Explain the following regarding interest rates:
 - 4.4.1 The concept of the real interest rate, including the Fisher effect. (4)
 - 4.4.2 The role of the interest rate in a net present value analysis of a potential capital project. (4)