



**FACULTY OF MANAGEMENT  
LAST ASSESSMENT OPPORTUNITY**

**DEPARTMENT OF BUSINESS MANAGEMENT**

**MODULE:** APPLIED MACROECONOMICS  
**CODE:** BMA9X03  
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**TOTAL MARKS:** 100

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**EXAMINER:** PROF S CHETTY  
**EXTERNAL MODERATOR:** PROF D BLAAUW  
**NUMBER OF PAGES:** 2

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**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**

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**QUESTION 1 (This question is compulsory)**

**[40]**

Given an environment of persistent negative sentiment and subdued domestic demand, real gross fixed capital formation (fixed investment) in South Africa dropped by 3,9% in 2016 after increasing by 2,5% in 2015. Although there was a noticeable increase in fixed capital formation expenditure by general government, there was a decline in the case of private businesses and public corporations in the fourth quarter of 2016. In the case of private businesses, fixed capital formation declined over five consecutive quarters. The third and fourth quarters of 2016 exhibited declines in private sector capital formation spending of 5,6% and 1,7% respectively. In addition to growth, the level of in gross fixed capital formation as a percentage of gross domestic product (GDP) is an important macroeconomic consideration. Gross fixed capital formation as a percentage of GDP fell from 20,4% in 2015 to 19,6% in 2016. Given this background, answer the following questions:

- 1.1 Explain the nature of fixed capital formation in terms of its components, general behaviour and macroeconomic importance. (5)
- 1.2 With the aid of a diagram depicting the investment function, analyse the theoretical relationship between capital formation and the interest rate, by bringing into consideration the expected rate of return on investment. (10)
- 1.3 In the scenario depicted above, the decline in private sector capital formation is attributed to persistent negative sentiment. Evaluate South Africa's investment (capital formation) climate with reference to **THREE** key factors which contribute to such negative private investor sentiment. You may include in your answer any recent developments that may negatively impact private sector investment behaviour going forward. (12)

- 1.4 With the use of the aggregate demand and supply model, analyse and illustrate the short- and long-run effects of a **demand contraction** that follows a **decline in capital formation (investment)** spending such as that indicated in the scenario depicted above. Start from an initial position of long-run structural equilibrium which is below full employment. (13)

## QUESTION 2

[30]

- 2.1 Explain the concept of economic growth as measured by GDP and evaluate its link with employment creation with the use of the macroeconomic employment coefficient with particular reference to the South African economy. (8)
- 2.2 Explain and illustrate the Phillips curve in terms of its theoretical arguments, and how it can be interpreted to present a menu of policy options for government in the short-run. (10)
- 2.3 Unemployment in South Africa is considered to be predominantly of a structural nature, causing the economy to persist well below its full employment level. In this regard, discuss **THREE** causes of structural unemployment in South Africa. (12)

## QUESTION 3

[30]

- 3.1 Explain the concept of inflation and its redistributive impact in terms of bracket creep within a progressive income tax system. (5)
- 3.2 Discuss, broadly, the policy implications of the Keynesian School. (5)
- 3.3 Suppose the South African Reserve Bank (SARB) engages in a series of increases in the repo rate in response to rising inflationary pressure in order to keep inflation within its targeted range. Explain **THREE** implications of **higher** interest rates for private business. (9)
- 3.4 The size of the public (government) debt is an important consideration for fiscal sustainability. According to the 2017 Budget Review, government debt stands at 50,7% of GDP, and is expected to stabilise at 48,2% in 2020/21. Given this short background, answer the following questions:
- 3.4.1 Explain how the public debt-to-GDP ratio is used to assess fiscal sustainability. (3)
- 3.4.2 Make use of the public debt-to-GDP ratio, taking into account prevailing economic conditions and recent developments, to evaluate South Africa's ability to achieve fiscal sustainability. (8)

## QUESTION 4

[30]

- 4.1 Explain how balance of payments disequilibria can occur and analyse the link between such disequilibria and exchange rate movements. (10)
- 4.2 Suppose that the South African rand sustains a significant depreciation on the foreign exchange market. Analyse **TWO** ways in which this can impact private business. (6)
- 4.3 Explain the meaning and relevance of the real exchange rate. (5)
- 4.4 Suppose that there is a substantial net outflow of foreign capital from the South African economy. Given that South Africa follows a flexible (floating) exchange rate system, make use of a diagram depicting the foreign exchange market for US dollars in terms of rand, to analyse the impact of the net outflow of foreign capital. (9)