UNIVERSITY OF JOHANNESBURG

FACULTY/COLLEGE	College of Business and Economics
SCHOOL	Johannesburg Business School
DEPARTMENT	Business Management
CAMPUS(ES)	APK
MODULE NAME	Applied Macroeconomics
MODULE CODE	BMA9x03
SEMESTER	First
ASSESSMENT OPPORTUNITY, MONTH AND YEAR	Supplementary Summative Assessment Opportunity **July 2019**

ASSESSMENT DATE	25 July 2019	**SESSION**	08:30 – 11:30
ASSESSOR(S)	Prof S Chetty		
MODERATOR(S)	Prof AM Pretorius		
DURATION	3 hours (180 min)	**TOTAL MARKS**	100

NUMBER OF PAGES OF QUESTION PAPER (Including cover page)	3

INFORMATION/INSTRUCTIONS:

- This is a **closed-book** assessment.
- There are 4 questions. **Answer question 1 (compulsory) plus 2 other questions.** (In total you must answer 3 questions)
- Answer each question in a separate book.
- Read the questions carefully and answer only what is required.
- Number your answers clearly and correctly as per the question paper.
- Write neatly and legibly on both sides of the paper in the answer book, starting on the first page.

QUESTION 1 (THIS QUESTION IS COMPULSORY) [40 MARKS]

It is argued that low and stable price inflation is important for balanced and sustainable economic growth. Hence South Africa follows a policy of inflation targeting and by so doing, attempts to anchor inflation expectations through an announced inflation target of 3 to 6 percent. The main policy instrument used by the Central Bank is the repurchase (repo) interest rate. Given the nature of South Africa's economy, particularly in terms of its underlying structural issues, the Central Bank follows a flexible inflation targeting regime.

The actual inflation rate tends persists above the midpoint of the inflation target. In fact, the inflation rate as measured by the consumer price index (CPI), has over the past decade averaged at a monthly rate of 5,5%. The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) has observed, in recent months, a moderation of inflation expectations and outcomes. The year-on-year CPI inflation rate was recorded at 4,1% in February 2019, just slightly above the 4% for January 2019.

According to the MPC's assessment at the end of March 2019, the overall risks to South Africa's inflation outlook are somewhat evenly balanced. Hence it decided to keep the repo rate unchanged at 6,75% per annum.

Given this background, answer the following questions:

1.1 Discuss the argument that low and stable inflation contributes to a balanced and sustainable economic growth. (6)

1.2 According to the MPC, the overall risks to South Africa's inflation outlook are somewhat evenly balanced. Critically evaluate this view, with reference to **THREE** key factors that have a bearing on South Africa's inflation outlook. (12)

1.3 Suppose that due to an improvement in South Africa's inflation outlook, the MPC decides to engage in a series of interest rate decreases. With the use of the aggregate demand and supply model, analyse and illustrate the short- and long-run effects of a **demand expansion** that follows lower interest rates. Start from an initial position of long-run structural equilibrium which is below full employment. (13)

1.4 Explain clearly **THREE** implications of a declining trend in interest rates for private business. (9)

QUESTION 2 **[30 MARKS]**

2.1 Fixed capital formation (fixed investment) is considered to be of critical importance for the long-term economic growth potential of a country. Discuss this statement. (6)

2.2 With the aid of a diagram depicting the investment curve, analyse the interplay between interest rates and expected returns on investment projects in terms of their effect on investment decisions. (12)

2.3 The REM/BER business confidence index declined by 3 points to 28 in the first quarter of 2019 when compared to the previous period. This decline is also likely to reflect in an increase in investor uncertainty. Critically evaluate **TWO** factors that contribute to increased investor uncertainty in South Africa (particularly in respect of fixed capital formation); and with the aid of a diagram depicting the investment curve illustrate and explain the impact of an increase in investor uncertainty. (12)

QUESTION 3 **[30 MARKS]**

3.1 Compare the Keynesian and Classical views on the ability of an economy to attain/maintain full employment equilibrium and the implications for active aggregate demand management policies. (8)

3.2 Employment creation is high on South Africa's policy agenda. The goal, according to the National Development Plan, is to reduce the unemployment rate to 14% by 2020 and 6% by 2030 through the creation of 11 million new jobs. Critically evaluate, **THREE** factors that continue to present a challenge to government in its effort to reduce unemployment to desired levels. (12)

3.3 The Phillips curve postulates a trade-off between unemployment and inflation. Explain the theoretical arguments behind this relationship and critically evaluate its appropriateness for policy decisions in an environment of high unemployment and high inflation, which is often experienced in South Africa. (10)

QUESTION 4 **[30 MARKS]**

4.1 It is often argued that economic growth measured by GDP or GDP per capita is not an appropriate or adequate measure of economic progress, particularly in respect of welfare and development. Debate this view. (10)

4.2 Discuss the challenge of using fiscal policy to stimulate economic growth in South Africa, taking into account the country's high public debt and the government's aim to achieve fiscal sustainability. (8)

4.3 The South African rand tends to rank high on the list of highly traded currencies in the world and has demonstrated considerable volatility over time. Discuss **THREE** implications of rand volatility on the foreign exchange market for private business in South Africa. (12)