

UNIVERSITY OF FORT HARE
DEPARTMENT OF ECONOMICS
ALICE AND EAST LONDON CAMPUSES

ECO 326/ ECO 326E

NOVEMBER EXAMINATIONS

2019

Time: 3 Hours

Subject: Economics 3- Money, Banking and International finance

Marks: 100

This paper consists of 4 pages including the cover page

Internal Examiners

Mr C. Wilson

Mr P. Ngonisa

External Examiner

Prof A. Maredza

Instructions

Answer FOUR (4) questions ONLY.

All questions carry EQUAL marks.

QUESTION 1

- a) Explain the evolution of money and payment system up to date and comment if we are headed for a cashless society. [12 marks]
- b) One of the factors contributing to the financial crisis of 2007 – 2009 was the widespread issuance of subprime mortgages. How does this demonstrate adverse selection? [13 marks]

QUESTION 2

- a) Discuss the role of credit rating agencies in stimulating economic growth within the framework of South Africa. [7 marks]
- b) A good theory of the term structure of interest rates must explain three empirical facts;
 - i. Interest rates on bonds of different maturities move together over time
 - ii. When short-term interest rates are low, yield curves are more likely to have an upward slope and when short-term rates are high, yield curves are more likely to become inverted
 - iii. Yield curves almost always slope upwards.

Discuss the three theories of the term structure; highlighting the one which does a good job in explaining the three empirical facts. [18 marks]

QUESTION 3

"President Cyril Ramaphosa delivered a major blow to the rand this week after making it explicitly clear that the ANC, and thus government, will move ahead with its goal to nationalise the South African Reserve Bank" [Adopted from BusinessTech, 09 March 2019]

- i. Do you think the South African Reserve Bank (SARB) is fully independent in its operations. [10 marks]
- ii. In view of the recent proposal of nationalising SARB, to what extent do you think this will interfere with the SARB's mandate. [10 marks]
- iii. Discuss the mandate of SARB. [5 marks]

QUESTION 4

- a) Does a higher rate of growth of the money supply always lower interest rates? Discuss. [12 marks]
- b) Explain and clearly illustrate why bonds with the same maturity have different interest rates. [9 marks]
- c) Illustrate and explain the liquidity trap. [4 marks]

QUESTION 5

Suppose the Yield to Maturity (YTM) of a bond suddenly increases, (equivalently, the bond market price decreases).

- a. (i) Who gains and who loses when this occurs? [2 marks]
(ii) In particular, are people who already own the bond better or worse off? Why? [3 marks]
- b. (i) Are people who are planning to buy the bond better or worse off? Why? [3 marks]
- c. Calculate the YTM for the Simple Loan based on the following Question.

Jameson, a shoe repair, borrows R500 from his neighbour Hector. Hector agreed to the deal only if Jameson would return the money as R600 from him after a year. What is the YTM on this loan? [8 marks]
- d. In August 2019, the US Federal Reserve cut its main interest rate by 25 basis points in its mid-cycle adjustments to policy and this led to the rand (ZAR) losing its value by -1.06. Given that America is the main trading partner of South Africa, what is the implication of this mid cycle adjustment to the South African economy focusing on the behaviour of local interest rates, exchange rates and capital/trade flows [9 marks]

QUESTION 6

- a) Discuss the money-supply-multiplier and the flow of funds approach of money supply determination. [18 marks]
- b) Compare and contrast direct and indirect finance in the context of the South African financial system. [7 marks]

END OF THE EXAMINATION PAPER