



University of Fort Hare

Together in Excellence

MAIN EXAM: NOVEMBER 2025

<u>FACULTY</u>	Management and Commerce
<u>DEPARTMENT</u>	Accounting, Economics and Finance
<u>QUALIFICATION:</u>	BCom Economics (Honours)
<u>SUBJECT:</u>	Monetary Economics
<u>SUBJECT CODE:</u>	ECO516E
<u>EXAMINER/S:</u>	Prof. M. Simatele, Mr. O.L. Kolawole
<u>MODERATOR</u>	Prof S Khumalo
<u>DURATION:</u>	3 Hours
<u>MARKS</u>	100
<u>ASSESSMENT WEIGHTING:</u>	50%

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This paper consists of 6 pages, including the cover page

INSTRUCTIONS

- Answer all questions in Section A, and any two questions in Section B. Section C is compulsory
- Graphs, where applicable, must be clear and well-labelled.
- Marks will be awarded for relevant examples and correctly labelled graphs.

This paper consists of 5 pages, including the cover page

SECTION A: Short-answer questions (5 Marks Each)

[Answer all questions in this section. Each question carries 5 marks.]

1. How do monetarists think changes in money supply affect output and prices?
2. The SARB cannot set prices directly. How does it still guide inflation?
3. What is the role of velocity in the quantity theory of money, and why does it matter for inflation?
4. How do commercial banks create money in the endogenous money approach?
5. Why do modern central banks prefer targeting interest rates rather than money supply?

SECTION B (20 Marks Each)

[There are four (4) questions in this section. Answer any TWO (2) questions from this section. Each main question carries 20 marks. Show all calculations where applicable.]

Question 1 [20 Marks]

- (a) Distinguish between market-based instruments and direct controls as tools of monetary policy. For each category, provide a specific example and briefly explain its mechanism. **(6 marks)**
- (b) How do problems in financial markets, like a lack of information or limited credit, change how monetary policy works? **(6 marks)**
- (c) Why is transparency important for central banks? How does it affect the transmission mechanism? **(8 marks)**

Question 2 [20 Marks]

- (a) Use the Mundell–Fleming model to explain why monetary policy does not work under fixed exchange rates with free capital flows. **(8 marks)**
- (b) Explain the trade-offs that the South African Reserve Bank (and South Africa as a whole) could face if it decided to target the exchange rate instead of inflation. **(8 marks)**
- (c) Identify South Africa's exchange rate regime and discuss the key advantages and disadvantages of adopting this regime for monetary policy? **(4 marks)**

Question 3 [20 Marks]

- (a) Using the liquidity preference model, show how lower interest rates affect money demand. **(6 marks)**
- (b) Explain the effect of an increase in nominal income on money demand. **(6 marks)**

(c) What is a liquidity trap? Why does it limit conventional monetary policy? **(8 marks)**

Question 4 [20 Marks]

- (a) Using the quantity theory of money, calculate the expected inflation rate if the money supply grows by 8% and real GDP grows by 3%, and velocity. Show your steps clearly. **(5 marks)**
- (b) Suppose the SARB raises money supply growth to 10%. Explain the likely short-run and long-run effects on output and prices. **(5 marks)**
- (c) Calculate the multiplier if the reserve requirement is 10% and the cash–deposit ratio is 0.2. **(5 marks)**
- (d) Briefly discuss how financial innovations such as mobile money or fintech might affect the money multiplier and the central bank's ability to control the money supply. **(5 marks)**

SECTION C - Compulsory (35 Marks): YOU MUST ANSWER THIS QUESTION

[Read the article below and answer the questions that follow.]

South African central bank holds key rate to assess impact of earlier cuts (Reuters, 18/9/25)

PRETORIA, Sept 18 (Reuters) - South Africa's central bank left its key lending rate at 7% in a tight decision, holding off from easing monetary policy further while it assesses the impact of previous rate cuts. Thursday's policy announcement was the first since the South African Reserve Bank (SARB) said it would aim for the bottom of its 3% to 6% inflation target range rather than the middle, an effort to lock in low inflation.

The Monetary Policy Committee was split, with four members preferring no change in the repo rate (ZAREPO=ECI), opens new tab , and two favouring a 25 basis point cut. SARB Governor Lesetja Kganyago said the effects of 125 basis points of rate cuts since September 2024 were still filtering through in Africa's biggest economy. "We want to see how this is affecting the economy, how expectations evolve, and how inflation risks are resolved," Kganyago told a press conference.

Economists polled by Reuters had expected a close call on Thursday after annual inflation unexpectedly slowed in August (ZACPIY=ECI), opens new tab , falling to 3.3% from July's 3.5% reading.

Well-contained inflation has allowed the SARB to cut its repo rate three times this year, including at its last meeting in July. Since then, U.S. President Donald Trump imposed a steep 30% tariff on South African goods, but the full effects are yet to be felt. The central

bank has said U.S. tariffs could cause tens of thousands of job losses in South Africa, though it thinks the overall impact on local inflation and economic growth could be modest.

On Thursday, the bank said it now expects inflation to average 3.4% this year, marginally higher than a July forecast of 3.3%. It raised its economic growth forecast for this year to 1.2% from 0.9%, reflecting a better-than-expected performance in the second quarter.

Answer the following questions. Refer to the specific data and statements from the article when answering. Include all diagrams as required.

- (a) Draw a money market diagram showing how the earlier 125 basis point repo cuts since September 2024 lowered interest rates. Why might the SARB now prefer to keep the repo rate steady at 7.0% instead of cutting further? **(6 marks)**
- (b) Using the article, explain three channels through which the earlier repo cuts could affect the economy. For each channel, show the flow of effects (e.g. repo rate $\downarrow \rightarrow$ credit cheaper $\rightarrow$ investment $\uparrow \rightarrow$ GDP $\uparrow$). Refer to details such as weak investment, global demand, or household borrowing. **(7 Marks)**
- (c) Using the Phillips curve, explain the relationship between inflation and unemployment/output. Apply this to South Africa: how might the SARB's shift to a 3% inflation target affect unemployment and output in the short run vs. the long run? Use the data from the article (inflation at 3.3%, weak GDP growth at 1%). **(7 marks)**
- (d) Draw an AD–AS diagram to show the short-run effect of the earlier repo cuts on output and inflation. How do food and fuel price increases complicate this outcome? **(6 marks)**
- (e) What are the benefits and risks of lowering the target from 4.5% to 3%? Under what conditions would this policy succeed? In your response mention credibility and the risk of time inconsistency raised in the article. **(5 marks)**
- (f) Suggest two measures that the SARB could use to protect its credibility and avoid political pressure to relax policy for short-term growth. **(4 marks)**

.....**END OF EXAMINATION**.....

All the best