



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

BACHELOR OF ARTS

EAE 308: INTERNATIONAL ECONOMICS II

DATE: 26/3/2021

TIME: 8.30-10.30 AM

INSTRUCTIONS:

- (i) Answer question one (Compulsory) and any other two questions
- (ii) Do not write on the question paper
- (iii) Show your working clearly

QUESTION ONE (COMPULSORY) (30 MARKS)

- a) Explain the following concepts
- i. Foreign Exchange Market (2 marks)
 - ii. Balance of Payments (2 marks)
 - iii. Trade Balance (2 marks)
 - iv. Economic Integration (2 marks)
- b) The fundamental equations in an economy are given as:
- Consumption function (C) = $100 + 0.9Y^d$
- Investment function (\bar{I}) = $600 - 30i$
- Income Tax (T) = $\frac{1}{3}Y$
- Government Expenditure (G) = 300
- Exports (X) = 70

Imports (M)	= 12 + 0.2Y
Transaction demand for money (Md1)	= 0.4Y
Speculative demand for money (Md2)	= -50i
Money supply (M)	= 520

You are required to calculate the following:

- i. IS curve (3 marks)
 - ii. LM curve (2 marks)
 - iii. Equilibrium income and interest rate (4 marks)
 - iv. Find the equilibrium level of income and the net exports when the net export function becomes $50 - 0.3Y$ (3 marks)
- c) Explain stages of Economic Integration (10 marks)

QUESTION TWO (20 MARKS)

- a) Explain three main functions of foreign exchange market (6 marks)
- b) Explain four differences between a futures contract and forward contract (8 marks)
- c) Suppose a Kenyan importer has ordered 200 computers from the USA at a price of US\$ 2,000 each. The total payment of US\$ 400,000 is due in 100 days' time after all the computers have been delivered in Kenya. Since the contract is written in dollars, there is a possibility of a change in the Ksh exchange rate during the period. Explain two main options the Kenyan importer faces and the repercussion to be experienced in each case. (6 marks)

QUESTION THREE (20 MARKS)

- a) Define the concept "Exchange Rate Regime" and explain four exchange rate regimes which exist (10 marks)
- b) With aid of a well labeled diagram explain the effect of increase in exports on the simultaneous equilibrium in the real and monetary sectors of the economy (6 marks)
- c) Explain the Marshal Lerner Condition (4 marks)

QUESTION FOUR (20 MARKS)

- a) Explain how Foreign Exchange Markets are interconnected with Financial Markets (8 marks)
- b) State reasons why there is demand for foreign currency and supply of foreign currency (6 marks)
- c) Explain how World Bank was formed and its roles (6 marks)

QUESTION FIVE (20 MARKS)

- a) Explain how the gold standard system work in practice and state problems associated with the Bretton woods system (8 marks)
- b) With aid of a diagram, explain how the disequilibrium state in a country which uses floating exchange rate regime is returned back to equilibrium (8 marks)
- c) State four components of International Financial Environment (4 marks)