



MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

BACHELOR OF ARTS

EAE 308: INTERNATIONAL ECONOMICS II

DATE: 17/11/2020

TIME: 2:00 – 4:00 PM

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 four main functions of International Finance. (4 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)	$= \frac{1}{3}Y$
Transfer payments (TR)	$= 60$
Government Expenditure (G)	$= 300$
Exports (X)	$= 70$
Imports (M)	$= 12 + 0.2Y$
Transaction demand for money (Md1)	$= 0.4Y$
Speculative demand for money (Md2)	$= -50i$
Nominal money supply (M)	$= 1040$
Price level (P)	$= 2$

You are required to ascertain the following:

- i) IS curve (3 marks)
 - ii) LM curve (2 marks)
 - iii) Equilibrium income and interest rate (4 marks)
 - iv) Foreign trade multiplier (2 marks)
- c) If a Kenyan importer orders US\$ 100,000 worth of Dell computers from the USA and payment is to be effected in 100 days' time, explain three main options the importer has at his disposal, if he suspects that the dollar price in Ksh may rise in the 100-days waiting period. (3 marks)
- d) Explain how balance of balance of payment deficit is corrected under fixed exchange rate regime. (5 marks)
- e) Demonstrate the equilibrium condition of the Covered Interest Parity. (4 marks)
- f) Graphically show the simultaneous equilibrium in the open economy use IS, LM and BP curves as a tool of macroeconomic analysis. (3 marks)

QUESTION TWO (20 MARKS)

- a) With aid of a well labeled diagram explain the welfare effects of economic integration in a small country. (8 marks)
- b) Explain criticisms labeled against IMF, World Bank and World Trade Organization. (6 marks)
- c) Discuss why the Bretton Woods system of exchange regime collapsed. (6 marks)

QUESTION THREE (20 MARKS)

- a) State and demonstrate the Marshall-Lerner Finance (6 marks)
- b) With aid of a well labeled diagram explain the increase in autonomous imports of the simultaneous equilibrium in the real and monetary sectors of the economy (8 marks)
- c) Explain the link between foreign exchange markets and financial markets (6 marks)

QUESTION FOUR (20 MARKS)

- a) Explain three main components of the balance of payments (6 marks)
- b) Demonstrate the derivation of the IS and LM curves (8 marks)
- c) Clearly explain the difference between the futures and forward contracts (6 marks)

QUESTION FIVE (20 MARKS)

- a) Explain why the law of one price is less relevant to trade in manufactured goods. (6 marks)
- b) Using a well labeled diagram explain the effects of exchange rate on the quantity supplied of foreign exchange. (8 marks)
- c) Using a well labeled diagram explain how the equilibrium exchange rate is determined in an economy which uses flexible exchange rate regime and explain how any deviation from the equilibrium is restored. (6 marks)