



MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

BACHELOR OF ECONOMICS & STATISTICS

BACHELOR OF ECONOMICS & FINANCE

BACHELOR OF ARTS

EAE 308: INTERNATIONAL ECONOMICS II

DATE: 25/7/2019

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) Devaluation (2 marks)
 - ii) Balance of Payments (2 marks)
 - iii) Nominal Price (2 marks)
 - iv) Hedging (2 marks)
- b) The fundamental equations in an economy are given as:

Consumption function (C)	$= 140 + 0.9 Y_d$
Investment function ($\bar{I}$)	$= 400$
Tax	$= 0.3Y$
Government Expenditure (G)	$= 800$
Exports (X)	$= 600$
Imports (M)	$= 0.15Y$

You are required to ascertain the following:

- i) Find the equilibrium level of income (4 marks)
 - ii) Find the net exports at equilibrium level of income (2 marks)
 - iii) Find the equilibrium level of income and the net exports when there is an increase in investment from 400 to 420 (2 marks)
 - iv) Find the equilibrium level of income and the net exports when the net export function becomes $800 - 0.05Y$ (2 marks)
- (c) Define the concept “Exchange Rate Regime” and state four exchange rate regimes which exist. (4 marks)
- (d) With aid of a diagram, explain how the disequilibrium state in a country which uses floating exchange rate regime is returned back to equilibrium (6 marks)

QUESTION TWO (20 MARKS)

- a) 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)
- b) State four components of International Financial Environment (4 marks)

QUESTION THREE (20 MARKS)

- a) Explain how Foreign Exchange Markets are interconnected with Financial Markets (5 marks)
- b) State reasons why there is demand for foreign currency and supply of foreign currency (5 marks)

QUESTION FOUR(20 MARKS)

- a) Explain the concept “ Balance of Payment Deficit” (2 marks)
- b) Explain how balance of payment Deficit is corrected under fixed exchange rate (8 marks)
- c) Explain how IMF, World Bank and World Trade Organisation were founded, for what purpose and how they operate (10 marks)

QUESTION FIVE (20 MARKS)

- a) With aid of a well labeled diagram explain decrease in autonomous imports of the simultaneous equilibrium in the real and monetary sectors of the economy (10 marks)
- b) Explain welfare effects of economic integration for a small country (10 marks)