KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS AND FINANCE

EAE 200: ECONOMICS OF GLOBAL BUSINESS

DATE: Monday 27th November 2017 **TIME: 8.00a.m -10.00a.m**

INSTRUCTIONS:

1. *Answer question one and any other two questions*
2. *Question one is compulsory and carries 30 marks*
3. *All other questions carry 20 marks each*

QUESTION ONE (*COMPULSORY*) – (30 marks)

a) Identify factors that help determine exchange rates and their impact on business. [5 marks]

b) Distinguish between the following terms:-

i. Dominant strategy and secure strategy. [2 marks]

ii. Simultaneous-move game and sequential-move game. [2 marks]

c) What is the difference between international portfolio investment and foreign direct investment, and what role did these capital flows play in recent financial crises? [6 marks]

d) Country X is about to join country Y in a free-trade area. Before the union, X imports 10 million transistor radios from the outside world market at $100 and adds a tariff of $30 on each radio. It takes $110 to produce each transistor radio in Y.

Required:-

i. Once the free-trade area is formed, what will be the cost to homeland of the transistor radio trade diverted to country Y? [2 Marks]

ii. How much extra imports would have to be generated in country X to offset this trade – diversion cost? [3 marks]

e) Suppose that Kenya currently imports 1.0 million pairs of shoes from China at $20 each. With a 50 percent tariff, the consumer price in Kenya is $30. The price of shoes in Uganda is $25. Suppose that as a result of the EAC (East African Community), Kenya imports 1.2 million pairs of shoes from Uganda and none from China.
What are the gains and losses to:-

i. Kenya consumers? [3 marks]

ii. Kenya producers? [3 marks]

iii. The Kenyan government? [2 marks]

iv. The world as a whole? [2 marks]

QUESTION TWO – (20 marks)

a) Table 1-A: Spot and forward exchange rates.

	Quotation*	Spot Rate	Forward Rate 1 Month	Forward Rate 3 Months	Forward Rate 1 Year
Europe					
EMU (euro)	Direct	1.2952	1.2956	1.2969	1.3069
Sweden (krona)	Indirect	6.9786	6.9756	6.9674	6.9078
Switzerland (Franc)	Indirect	1.1919	1.1901	1.1861	1.1651
United Kingdom (pound)	Direct	1.8704	1.8668	1.8607	1.8412
Americas					
Canada (dollar)	Indirect	1.2333	1.2334	1.2330	1.2282
Mexico (peso)	Indirect	11.2365	11.2985	11.4145	11.8775
Pacific /Africa					
Hong Kong (dollar)	Indirect	7.7989	7.7858	7.7626	7.6681
Japan (yen)	Indirect	103.155	102.935	102.465	99.930
South Africa (rand)	Indirect	6.0813	6.1071	6.1552	6.3518
South Korea (won)	Indirect	1032.50	1033.35	1033.85	1030.95

**Direct quotation: number of dollars per unit of foreign currency.*
Indirect quotation: units of foreign currency per dollar.
Source: Financial Times, January 21, 2005.

Use the above table (Table 1-A) to answer the following questions:-

i. How many euros can you buy for 1 dollar (an indirect quote)? [2 marks]

ii. How many dollars can you buy for 1 yen (a direct quote)? [2 marks]

iii. Table 1-A shows the exchange rate for the Swiss franc on January 20, 2005. The previous day, the spot rate of exchange for the Swiss franc was SFr1.1827/\$. Thus on January 20, you could buy more Swiss francs for your dollar than 1 day earlier. Did the Swiss franc appreciate or depreciate? [2 marks]

iv. Look at the exchange rates in Table 1-A. Does the Swiss franc sell at a forward premium or discount on the dollar? Does this suggest that the interest rate in Switzerland is higher or lower than in the United States? Use the interest rate parity relationship to estimate the 1 – year interest rate in Switzerland. Assume the U.S. interest rate is 3.25 percent. [2 marks]

b) Starlight Corporation borrows 100 million Japanese yen at an apparently attractive interest rate of 1 percent, when the exchange rate between the yen and the U.S. dollar is ¥103.155/\$. Suppose that1 year later, when Starlight has to repay its loan, the exchange rate is ¥98.20/\$. Calculate in U.S. dollars the amount that Starlight borrows and the amounts that it pays in interest and principal (assume annual interest payments). What is the effective U.S. dollar interest rate that Starlight has paid on the loan? [4 marks]

c) The spot exchange rate between the dollar and the Kenya Shilling is a floating, or flexible rate. What are the effects of each of the following on this exchange rate?

i. There is a large increase in Kenyans demand for U.S. exports as U.S. culture becomes more popular in Kenya. [2 marks]

ii. There is a large increase in Kenyan demand for investment in U.S. dollar denominated financial assets because of Kenyans belief that the U.S. economy and political situation are improving markedly. [2 marks]

iii. Political uncertainties in Kenya lead U.S. investors to shift their financial investments out of Kenya, back to the United States. [2 marks]

iv. U.S. demand for products imported from Kenya falls significantly as bad press reports lead Americans to question the quality of Kenyan products. [2 marks]

QUESTION THREE – (20 marks)

a) Define regional economic integration. [2 marks]

b) Explain five levels of regional economic integration. [10 marks]

c) Discuss any four costs of multinational corporations (MNCs) to developing countries. [8 marks]

QUESTION FOUR – (20 marks)

a) Distinguish with examples between foreign direct investment (FDI) and multinational corporation (MNC). [4 marks]

b) Discuss how global and regional efforts to promote trade and investment have advanced globalization. [8 marks]

c) Discuss the ways through which a country can cope with a financial crisis. [8 marks]

QUESTION FIVE – (20 marks)

a) A country currently prohibits any multinational national corporation (MNC) into the country. Its government is considering liberalizing this policy. You have been hired as a consultant (congratulations!) to a group of foreign firms that wants to see the policy loosened. They ask you to prepare a report on the major arguments for why the country should liberalize this policy. What will your report say? [10 marks]

b) Using a well labeled partial equilibrium diagram, illustrate and discuss the welfare effect of a trade diverting customs union. [10 marks]