Moderated 24/1/2020

# EAE 308: INTERNATIONAL ECONOMICS II EXAM
## 2ND SEMESTER (JAN-APRIL) 2019/2020.

**Kenyatta University**

Registration No.......................

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Question No..........................

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INSTRUCTIONS:

1 Question ONE (i) is compulsory (30 marks)

~~2 Answer any other questions~~

2 Answer any TWO (2) other questions (25 marks each).

Quetion One

a A Ugandan firm in 2019 owed Kenya Pipeline Company (KPC) LTD Ug. Sh 300 million for transportation of its petroleum products from Mombasa to the Eldoret oil terminal. Payment must be made in US dollars at the end of December 2019. On September 1st 2019 the Kenya shilling exchanged for Ugsh 30 and the US$ exchanged for Ksh 100 at the spot and Ksh 102 at the forward rate.

Required:

i) What are the various payment options facing the Ugandan firm indebted to KPC LTD? (4 marks)

ii) Under the current (2019) world economic conditions (where domestic exchange rates are potentially volatile), how will the Ugandan firm make its decisions concerning which payment option? (4 marks)

iii) Outline three (3) main reasons why the Ksh. has not been used in the final settlement of the above transaction? (6 marks)

iv) How many US$ will the Ugandan firm pay on [illegible] December 30th 2019? (6 marks)

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b Assume that a Kenyan arbitrageur with Ksh5 million faces the following spot exchange rates on 24/3/2020.

| | Ksh buying | Ksh selling |
|---|---|---|
| 1 US dollar | 102.244 | 102.4429 |
| 1 sterling pound | 145.4906 | 145.8172 |
| 1 Euro | 110.9194 | 111.1706 |

1 sterling pound = US$1.4189; 1 Euro = US$1.2893.

i) Show by calculation which foreign currency the Kenyan arbitrageur will trade in on March ~~24th 2020~~ 24th 2020.

ii) How much profit will the Kenyan arbitrageur make on the chosen currency that day compared to other foreign currencies?

Question Two.

a Give four (4) reasons why the international market for foreign exchange can be treated as competitive (4 marks)

b Use a simple demand and supply model to show how a country's foreign exchange rate is determined under a fixed exchange regime (8 marks

c In what way could Japanese investment in a vehicle assembly plant in Thika Town contribute both positively and negatively to Kenya's current account balance in the next 10 years (Present two positive and two negative contributions (8 marks

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Question Three.

a What are the main transactions on the current account balance? (6marks)

b What are the main transactions on the capital account balance? (2marks)

c What is the relationship between the official settlements balance, the current and the capital account balances? (2 marks)

d The balance of payments (b/p) represents the difference between receipts (credits) and payments (debits) for transactions undertaken by individuals, firms, and the government. Use a series of equations to show how a deficit or surplus in the country's balance of payments must be "accommodated" or "compensated for" by official transactions. (10 marks)

Question Four

a Outline the objectives of the International Monetary Fund and explain the different facilities that are available to countries seeking financial assistance (bail-out). (10marks)

b i) Decribe the purpose of foreign exchange reserves in an economy (4marks)
ii) Distinguish between fixed exchange rate system and a floating exchange rate system (6marks)

Question Five

With the aid of a sketch graph, explain trade diverting and trade creating effects of economic integration for a small country like Kenya. (20 marks)