AFRICA UNIVERSITY
A United Methodist-Related Institution

"Investing in Africa's Future"

COLLEGE OF BUSINESS PEACE LEADERSHIP AND GOVERNANCE

NMEC402 INTERNATIONAL ECONOMICS (FINANCE)

END OF SECOND SEMESTER EXAMINATIONS

MAY 2024

LECTURER: MR T MASESE

TIME: 3 HOURS

INSTRUCTIONS

Answer **ANY FOUR** Questions from this paper

MARKS ALLOTED TO EACH QUESTION ARE SHOWN

CLEAR AND NEATLY PRESENTED WORK WILL BE AWARDED MARKS FOR PRESENTATION

Question 1

a. Assess what a country's balance of payment is? If by definition a BOP account should balance, examine what is meant by a balance of payments deficit or surplus? **(5 marks)**

Assume two countries, the home country as country A and treat all foreign countries as one country, country B. Given the following different transactions, indicate the manner in which the transaction is recorded in country A's balance of payments. Prepare country A's balance of payments account indicating all the sections of the BOP. **(20 marks)**

Transaction	Description of Transaction
1.	Exporters of country A send \$6,000 of goods to country B, receiving in exchange a short-term bank deposit of \$6,000 in country B
2.	Country A's consumers purchase \$12,000 of goods from country B firms and that payment is made by citizens of country A by transferring \$12,000 to the bank accounts of country B firms in country A.
3.	Residents of country A send \$1,000 of goods to country B's citizens as a gift
4.	Country A firms provide \$2,000 of shipping services to country B firms. Country B firms pay for these services by transferring some of their account deposits in country A banks to the accounts of country A shipping firms in country A banks.
5.	A country B firm sends \$2,500 of dividends to its country A stockholders. Payment is made by the country B firm writing checks on its bank account in a country A bank. T
6.	A citizen of country A purchases a \$5,000 long-term corporate bond issued by a country B company. Payment is made by the A citizen by deducting this amount from his or her bank account in country A and transferring the funds to the country A bank account of the country B firm.
7.	Sale of \$800 foreign currency to country A's central bank by B's commercial banks.

Question 2

a. Applying the Mundell-Fleming model analyze the impact on domestic income, interest rate, current account (CA) and capital account (KA) of the following happenings:
   1. An increase of foreign interest rate;
   2. A fall of foreign demand on domestic goods.

Provide the above analysis for the following three different countries:

i. Country A with fixed exchange rate and perfect capital mobility. **(8 marks)**
ii. Country B with flexible exchange rate and imperfect capital mobility. **(8 marks)**
iii. Country C with fixed exchange rate and no capital mobility. **(9 marks)**

Question 3

a. Using the Monetary Approach to Exchange rate determination, consider the following hypothetical model of two countries, Zimbabwe and China assuming that the equation of exchange holds in each country:

Variable	**Zimbabwe**	**China**
Money Supply	US$1 000	300 000 yuan
Velocity of Circulation	2	3
Real Output	5 000	15000

Required:

i. Determine the equilibrium exchange rate (Yuan per dollar) given the above data. **(3 marks)**

ii. Explain what will happen to the equilibrium exchange rate when the following happen; (1) domestic money supply rises less rapidly than foreign money supply and (2) when foreign output rises faster than domestic output. **(8 marks)**

b. With the aid of well labelled diagrams and algebraic expressions, explain and differentiate how exchange rate overshooting occurs on the following models of exchange rate determination, showing clearly both the short-run and long-run equilibrium exchange rates:

i. Dornbusch Sticky price model. **(5 marks)**

ii. Portfolio Balance model. **(5 marks)**

iii. Critically assess the relevance of either the Dornbusch or the Portfolio balance model in explaining episodes of exchange misalignment in Zimbabwe. **(4 marks)**

Question 3

a. Suppose that the Zimbabwean government (small open economy with perfect capital mobility and flexible exchange rate) increases lump sum taxes. Compare the short and long run impact of such a policy on income, private savings, investment, real interest rate, trade balance and real exchange rate. **(12 marks)**

b. Briefly explain the following concepts: Forward exchange rate, spot exchange rate, hedging, currency depreciation, triangular arbitrage. **(5 marks)**

c. Explain the determinants of the demand and supply sides of the foreign exchange market **(8 marks)**

Question 4

a. Discuss the elasticity approach to the balance of payments and determine what has been the major weakness of this approach. **(8 marks)**

b. Use the open economy identities to illustrate that a country's balance of payments is determined by the private sector net savings/ dissaving and government budget deficits/surplus. **(3 marks)**

c. Assume that the marginal propensity to save is 0.2 and the marginal propensity to import is 0.1. Calculate the foreign trade or export multiplier. Determine the effect of an increase in exports of $100 million on national income. **(5 marks)**

d. Assume that the marginal propensity to save is 0.25 and the marginal propensity to import is 0.15. If government expenditure increases by $100 million, calculate the current account multiplier and derive the effects this increase in government expenditure on the current account balance. **(5 marks)**

e. Assume that the marginal propensity to save is 0.25 and the marginal propensity to import is 0.15. Calculate the effect of an $100 million increase in exports on the current account. **(4 marks)**

Question 5

a. Discuss the absorption approach to balance of payments and assess the effects of a devaluation on direct absorption? **(10 marks)**

b. The fundamental basis of the monetary approach is that balance of payments is essentially a monetary phenomenon. Discuss this statement with reference to the monetary approach to BOP and highlight the criticisms of the monetary approach. **(15 marks)**

END OF EXAMINATION