



# **AFRICAN ECONOMIC RESEARCH CONSORTIUM**

**Collaborative Masters Programme in Economics for Anglophone Africa  
(Except Nigeria)**

**JOINT FACILITY FOR ELECTIVES (JFE) 2015**

**JUNE – SEPTEMBER**

## **INTERNATIONAL ECONOMICS II**

**Second Semester: Final Examination**

**Duration: 3 Hours**

**Date: Monday, September 14, 2015**

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### **INSTRUCTIONS:**

1. Answer **ANY FOUR** questions.
  2. Draw appropriate and clearly labeled diagrams where necessary.
  3. Candidates are allowed to use calculators during the examination.
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### **Question 1**

- (a) Explain how devaluation affects the current account and national income according to the absorption approach to the balance of payments. **(12 marks)**
- (b) In terms of the monetary approach to the balance of payments, explain and illustrate the effects of an increase in foreign prices under fixed exchange rate system. **(13 marks)**

### **Question 2**

- (a) Distinguish between absolute and relative purchasing power parity. **(5 marks)**
- (b) Discuss the macroeconomic trilemma and show how it affects African countries. **(12 marks)**
- (c) Using the portfolio balance approach to exchange rate determination, explain and illustrate the effects of a contractionary sterilized foreign exchange operation (SFXO). **(8 marks)**



### Question 3

- (a) Distinguish between nominal and real exchange rates. (5 marks)
- (b) Outlining the basic assumptions, clearly explain how the specie flow mechanism corrects a balance of payments surplus. (8 marks)
- (c) Based on the monetary approach to the balance of payments (MABP), with the aid of illustrative diagrams, compare and contrast the effects of a monetary expansion under floating and fixed exchange rate systems. (12 marks)

### Question 4

- (a) Given the equation  $\ln(E) = \ln M - \ln M^* - \beta(\ln y - \ln y^*) + \varepsilon(\dot{m}/m - \dot{m}^*/m^*)$ , explain fully how increases in domestic income and the money supply growth rate will affect the exchange rate, prices and real money balances. What type of expectations is being assumed in this model specification? Explain your answer. (12 marks)
- (b) Using the Mundell-Fleming model, explain the effects of a fiscal contraction under fixed exchange rates and perfect capital mobility. (13 marks)

### Question 5

- (a) Briefly explain the benefits of participating in a common currency area. (10 marks)
- (b) Using Kouri (1983)'s extension of the portfolio balance approach to exchange rate determination, explain the interaction between the current and capital accounts. (15 marks)