

AFRICAN ECONOMIC RESEARCH CONSORTIUM

Collaborative MA Programme in Economics for Anglophone Africa
(Except Nigeria)

JOINT FACILITY FOR ELECTIVES JUNE – OCTOBER 2005

INTERNATIONAL ECONOMICS

Second Semester: Final Examination

Time: 09.00 AM – 12.00 Noon

Monday September 26, 2005

INSTRUCTION: Explore mathematical models with clearly identified variables and/or clearly labeled diagram(s) to support your discussion where appropriate. Clearly highlight all simplifying and underlying assumptions. Your answers should be well structured and straight to the point. ANSWER QUESTION 1 AND THREE OTHER QUESTIONS.

Question 1.

Elaborate the following concepts:

- (a) Uncovered interest parity condition (4 marks)
- (b) The J-curve effect (4 marks)
- (c) Internal/external balance (4 marks)
- (d) Purchasing power parity (3 marks)

Question 2.

Carefully explain why the monetary and the traditional elasticities and income approaches to exchange rate determination give contradictory results. What insights do the models give for the implementation of exchange rate policies in developing countries? (15 marks)

Question 3.

‘Expectations play a major role in the determination of spot exchange rates.’ Explain using a simple model the relationship between money supply, interest rates, exchange rates and expectations. How would you use your model to guide exchange rate policies in a developing country? *(15 marks)*

Question 4.

Explain the relative effectiveness of fiscal and monetary policy in a small open economy with interest rate sensitive international capital flows under fixed and floating exchange rates. *(15 marks)*

Question 5.

‘Central Banks must never interfere in foreign exchange markets.’ Give a critical assessment of the statement. Use the simple monetarist model of a small open economy to discuss the optimality of Central Banks’ foreign exchange market intervention. *(15 marks)*

Question 6.

- (a) Explain how the benefits and costs of imposing controls on short term capital inflows can be assessed. *(7 marks)*
- (b) Is it true to say that short term rather than long term capital flows have been the major cause of the debt crises? Critically assess the major causes of capital flight from Africa. *(8 marks)*