University of Colorado at Boulder

Department of Economics

ECON 4423: INTERNATIONAL FINANCE
Term Test 1
Fall 2004

Name: Answer Key
Student ID: ______________________________

Instructions:
- This test is 1 hour in length.
- You may use a hand calculator
- No Cell Phones
- Answer all questions.
- Section 1: Multiple Choice.
- Section 2: Problems.
- This test is x pages long (including cover).
Section 1: **Multiple Choice**

- Each question is worth 5 points, for a total of 50 points.

1. GNP equals GDP
   A. minus net receipts of factor income from the rest of the world.
   B. plus receipts of factor income from the rest of the world.
   C. minus receipts of factor income from the rest of the world.
   D. plus net receipts of factor income from the rest of the world.
   E. None of the above.

   Answer: D

2. In open economies,
   A. saving and investment are necessarily equal.
   B. as in a closed economy, saving and investment are not necessarily equal.
   C. saving and investment are not necessarily equal as they are in a closed economy.
   D. saving and investment are necessarily equal contrary to the case of a closed economy.
   E. None of the above.

   Answer: C

3. A country’s current account
   A. balance equals the change in its net foreign wealth.
   B. balance equals the change in its foreign wealth.
   C. surplus equals the change in its foreign wealth.
   D. deficit equals the change in its foreign wealth.
   E. None of the above.

   Answer: A

4. Which one of the following expressions is the most accurate?
   A. CA = EX – IM.
   B. CA = IM – EX.
   C. CA = EX = IM.
   D. CA = EX + IM.
   E. None of the above.

   Answer: A

5. The German currency is called the
   A. Euro
   B. DM
   C. Yen
   D. Dollar
   E. Pound

   Answer: A
6. How many British pounds would it cost to buy a pair of American designer jeans costing $45 if the exchange rate is 1.80 dollars per British pound?
   A. 10 British pounds
   B. 25 British pounds
   C. 20 British pounds
   D. 30 British pounds
   E. 40 British pounds

   Answer: B

7. Which one of the following statements is the most accurate?
   A. A depreciation of a country’s currency makes its goods cheaper for foreigners.
   B. A depreciation of a country’s currency makes its goods more expensive for foreigners.
   C. A depreciation of a country’s currency makes its goods cheaper for its own residents.
   D. A depreciation of a country’s currency makes its goods cheaper.
   E. None of the above.

   Answer: A

8. Which of the following statements is the most accurate?
   A. A rise in the interest rate offered by dollar deposits causes the dollar to appreciate.
   B. A rise in the interest rate offered by dollar deposits causes the dollar to depreciate.
   C. A rise in the interest rate offered by dollar deposits does not affect the U.S. dollar.
   D. For a given euro interest rate and constant expected exchange rate, a rise in the interest rate offered by dollar deposits causes the dollar to appreciate.
   E. None of the above.

   Answer: D

9. Which one of the following statements is the most accurate?
   A. A rise in the average value of transactions carried out by a household or a firm causes its demand for money to fall.
   B. A reduction in the average value of transactions carried out by a household or a firm causes its demand for money to rise.
   C. A rise in the average value of transactions carried out by a household or a firm causes its demand for money to rise.
   D. A rise in the average value of transactions carried out by a household or a firm causes its demand for nominal money to rise.
   E. A rise in the average value of transactions carried out by a household or a firm causes its demand for real money to rise.

   Answer: E

10. A temporary increase in a country’s money supply causes
    A. its currency to appreciate in the foreign exchange market, while a reduction in the money supply causes its currency to depreciate.
    B. its currency to depreciate in the foreign exchange market, while a reduction in the money supply causes its currency to appreciate.
    C. no effect on the values of its currency in international markets.
    D. its currency to depreciate in the foreign exchange market, while a reduction in the money supply causes its currency to further depreciate.
    E. None of the above.

    Answer: B
Section 2: Short Questions

Question 1. (20 points)
Suppose that the one-year forward F(USD/EUR) exchange rate is USD 1.26 per euro and the spot exchange rate is USD 1.20 per euro.
a) What is the forward premium on euro?
b) What is the difference between the interest rate on one-year dollar deposits and that on one year euro deposits (assuming no political risk)?

Question 2. (30 points)
For business purposes, your financial institution provides you with the following information on the Chilean Peso (CLP) and the Mexican Peso (MXN), where fcu means foreign currency units.

<table>
<thead>
<tr>
<th>USD/fcu</th>
<th>bid</th>
<th>ask</th>
</tr>
</thead>
<tbody>
<tr>
<td>CLP</td>
<td>0.001600</td>
<td>0.001640</td>
</tr>
<tr>
<td>MXN</td>
<td>0.08750</td>
<td>0.08770</td>
</tr>
</tbody>
</table>

a) Construct the synthetic or cross-rate bid for the CLP in units of MXN?
b) Construct the synthetic or cross-rate ask for the CLP in units of MXN?
c) Is it possible to observe the following direct quote for the CLP in units of MXN: bid MXN 0.01830/CLP and ask MXN 0.01835/CLP (Why?)

Bonus Question (10 points)
Is it possible to observe the following quotes? Why?

<table>
<thead>
<tr>
<th>USD/CAD</th>
<th>bid</th>
<th>ask</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spot</td>
<td>0.7845</td>
<td>0.7846</td>
</tr>
<tr>
<td>3-month Forward</td>
<td>0.7840</td>
<td>0.7850</td>
</tr>
</tbody>
</table>