MIDTERM REVIEW QUESTIONS MAY 2009:
Zahlungsbilanz und Devisenmarkt

(1) What accounts for most of the activity in the foreign exchange market?

(a) Inter-bank trading
(b) Government transfers
(c) Sale of good and services
(d) Government purchase of assets
(e) Foreign imports

Answer: A

(2) 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

(3) The aggregate money demand depends on

(a) The interest rate
(b) The price level
(c) Real national income
(d) All of the above.
(e) Only (a) and (c)

Answer: D

(4) The CA (current account) is equal to

(a) $Y - (C - I + G)$
(b) $Y + (C + I + G)$
(c) $Y - (C + I + G)$
(d) $Y - (C + I - G)$
(e) $Y - (C + I + G) = -CA$, (i.e., minus the CA)

Answer: C

(5) The expected real interest rate (r^e) in terms of the nominal interest rate (R) and the expected inflation rate (π^e) is given by

(a) $r^e = \pi^e + R$
(b) $r^e = 2\pi^e + R^2$
(c) $r^e = \pi^e + R^2$
(d) $r^e = R - \pi^e$
(e) $r^e = R^2 - \pi^e$

Answer: D

(6) Suppose that the one-year forward price of euros in terms of dollars is equal to \$1.113 per euro. Further, assume that the spot exchange rate is \$1.05 per euro, and the interest rate on dollar deposits is 10 percent and on euro it is 4 percent. Under these assumptions,

(a) Covered interest parity does hold.
(b) Covered interest parity does not hold.
(c) It is hard to tell whether covered interest parity does or does not hold.
(d) Not enough information is given to answer the question.
(e) None of the above.

Answer: B

(7) If the dollar interest rate is 10 percent and the euro interest rate is 6 percent, then

(a) An investor should invest only in dollars.
(b) An investor should invest only in euros.
(c) An investor should be indifferent between dollars and euros.
(d) It is impossible to tell given the information.
(e) All of the above.

Answer: D

(8) Interest rate differences between countries depend on

(a) differences in expected inflation, but not on expected changes in the real exchange rate
(b) differences in expected changes in the real exchange rate, but not on expected inflation
(c) neither differences in expected inflation, nor on expected changes in the real exchange rate
(d) differences in expected inflation and nothing else
(e) differences in expected inflation, and on expected changes in the real exchange rate

Answer: E

(9) An 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 it 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

(10) Covered interest parity says that

(a) Interest rates are equal in all currencies.
(b) rates of return on domestic currency deposits and "covered" foreign currency deposits using the forward exchange rate are the same
(c) exchange rate changes are based on parity conditions set by central banks
(d) short term exchange rates are a function of expectations about future interest rates.

Answer: B

(11) In the short-run, a temporary increase in the money supply

(a) Shifts the AA curve to the right, increases output and depreciates the currency
(b) Shifts the AA curve to the left, increases output and depreciates the currency
(c) Shifts the AA curve to the left, decreases output and depreciates the currency
(d) Shifts the AA curve to the left, increases output and appreciates the currency
(e) Shifts the AA curve to the right, increases output and appreciates the currency

Answer: A

(12) If the dollar interest rate is 10 percent, the euro interest rate is 12 percent, and the expected return on dollar depreciation against the euro is negative 4 percent, then

(a) An investor should invest only in dollars.
(b) An investor should invest only in euros.
(c) An investor should be indifferent between dollars and euros.
(d) It is impossible to tell given the information.
(e) All of the above.

Answer: A

(13) Forward and spot exchange rates

(a) Are necessarily equal
(b) Do not move closely together
(c) The forward exchange rate is always above the spot exchange rate.
(d) While not necessarily equal, do move closely together.
(e) None of the above.

Answer: D

(14) A foreign exchange swap

(a) Is a spot sale of a currency
(b) Is a forward repurchase of the currency
(c) Is a spot sale of a currency combined with a forward repurchase of the currency
(d) Is a spot sale of a currency combined with a forward sale of the currency
(e) None of the above.

Answer: C

(15) A reduction in a country's money supply causes:

(a) its currency to depreciate in the foreign exchange market
(b) its currency to appreciate in the foreign exchange market
(c) does not affect its currency in the foreign market
(d) does affect its currency in the foreign market in an ambiguous manor
(e) affects other countries currency in the foreign market

Answer: B

(16) The aggregate real money demand schedule L(R,Y)

(a) Slopes upward because a fall in the interest rate raises the desired real money holdings of each household and firm in the economy
(b) Slopes downward because a fall in the interest rate reduces the desired real money holdings of each household and firm in the economy
(c) Has a zero slope because a fall in the interest rate keeps constant the desired real money holdings of each household and firm in the economy
(d) Slopes downward because a fall in the interest rate raises the desired real money holdings of each household and firm in the economy
(e) None of the above.

Answer: D

(17) The real exchange rate, q, is defined as

(a) E
(b) E x P
(c) E x P^*
(d) (E x P^*)/P
(e) P/(E x P^*)

Answer: D

(18) The current (spot) exchange rate between currencies depends on

(a) The interest rate that can be earned on deposits of those currencies
(b) The expected future exchange rate
(c) The interest rate that can be earned on deposits of those currencies and the expected future exchange rate
(d) National output
(e) None of the above.

Answer: B

(19) After a permanent increase in the money supply,

(a) The exchange rate overshoots in the short run.
(b) The exchange rate overshoots in the long run.
(c) The exchange rate smoothly depreciates in the short run.
(d) The exchange rate smoothly appreciates in the short run.
(e) None of the above.

Answer: A

(20) If people expect relative PPP to hold,

(a) The difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected, in the United States and Europe, over the relevant horizon.
(b) The difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected in Europe and the United States.
(c) The difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected, over the relevant horizon, in the United States and Europe, in the short run.
(d) The difference between the interest rates offered by dollar and euro deposits will be above the difference between the inflation rates expected, over the relevant horizon, in the United States and Europe.

Answer: A