Part I. Short Answer Questions (5 points each)

1. Define and contrast triangular arbitrage and covered interest arbitrage.

2. What is the volume of daily transactions in foreign exchange among the world's banks? How do we know?
3. What are spot, forward, futures and swap markets in foreign exchange -- how do they differ, and who uses them?

4. If the Japanese yen goes from 90 yen per dollar to 85 yen per dollar, has the dollar appreciated or depreciated? Explain briefly.

5. Why did the yen appreciate after the recent earthquake and nuclear power plant meltdown?
6. Distinguish absolute and relative purchasing power parity.

7. Does absolute or relative purchasing power parity work better as an explanation of exchange rates? Why?

8. Does the version of purchasing power parity that works better to explain exchange rates work better in the long run or the short? Explain your answer.

9. Assuming that purchasing power parity works well as a theory of exchange rates, explain how an increase in a country's real GDP would impact on its currency -- would it appreciate or depreciate and why (extend the formula with the monetarist approach to exchange rates to demonstrate your answer; you may use either levels of GDP and other variables or percent changes in them).
10. What is exchange rate overshooting and why does it take place? What theory of exchange rates lies behind it?

11. What organization compiles the most complete survey of purchasing power parities? Explain how it does so with an example.

12. Supposing a country wants to defend a fixed value of its exchange rate: explain (in words and graphs) how it would do so:
   a. Against appreciation?
   b. Against depreciation?
13. Explain the problem(s) that might result from
   a. Defense against appreciation
   b. Defense against depreciation

14. What were the "rules of the game" of the gold standard in the 19th century?

15. Were those rules of the game always observed by central banks? Explain which rules were more frequently violated, by whom, and how.
International Economics
Dr. McGahagan
Final Exam - Spring 2011

NAME_______________________________________

Short Answer______    Longer Answer_______  Total_____

Longer questions: 10 points each.

1. Suppose the interest rate on 1 year Treasury Bills in the US is 2 percent and the interest rate on 1 year UK Treasury bills is 4 percent. If the current exchange rate is $ 1.50 per pound, what would the 1-year forward rate be? Explain how you know, and what would happen if the forward rate higher than your value.
2. Start from the definition that GDP = C + I + G + Exports - Imports and explain what the effect of an increase in the government budget deficit would be on the trade balance if everything else remained the same. Also explain what other changes might offset the predicted effect.
3. Why is the free movement of capital a good thing if the capital is productively invested? Draw a graph of the marginal productivity of physical capital (similar to the fixed factors model we met in discussing trade) to illustrate your argument.
4. Contrast the Keynes and White plans at Bretton Woods, and evaluate whether or not the full adoption of the Keynes plan would have prevented or delayed the breakdown of the Bretton Woods system.
5. What was the "global savings glut" of recent years. Why did it arise, and what impact did it have on the world economy?