Directions: Answer any three of the following questions; each has equal weight. Each has a very specific answer that can be reached using only a few brief sentences, usually combined with a graph or an equation. Please remember to label all graphs and show any mathematical work.

1. Balance of payments (BOP) accounts provide us with a variety of measures of international activity.
   a. BOP accounts are maintained according to the rules of double entry bookkeeping; all transactions are recorded as debits or credits. What is the general rule for determining whether a transaction is a debit or credit in a country’s BOP? Provide examples of a type of credit transaction for each the current account, financial account, and international reserves sections of the balance of payments. (Note: you do not need to identify currency amounts, simply indicate a type of transaction that provides the appropriate example.)
   b. What does the current account balance (CAB) measure? If a country has a current account deficit, what does that mean for that country?
   c. Assuming that net exports (X-M) are approximately equal to the CAB, use GDP account formulae to show the relationship between the CAB and national savings and investment. Given this formula, discuss how movements in either or both of these variables could lead to a CAB deficit.
   d. What does the official settlements balance (OSB) measure? If a country has an OSB surplus, what does that mean for that country?

2. Two conditions in the foreign exchange market are often assumed to hold true. These are covered and uncovered interest rate parity (CIRP and UIRP). What is the CIRP condition? (Note: you do not have to derive the formula.) Under what conditions is it most likely to hold? Explain. What is the UIRP condition. (Again, you do not have to derive the formula.) What role does UIRP in exchange rate economics? How well does it work in this role?

3. Over the past two centuries, there have been two extended periods of worldwide fixed exchange rates, the international gold standard and the Bretton Woods system. Compare and contrast these two systems in terms of the following:
   a. the amount and types of exchange rate movement allowable under the two systems and the factor or factors that determined the limits to exchange rate movements.
   b. the role of speculators in stabilizing or destabilizing the systems.
   c. the role of international organizations in the systems.
   d. the duties of national central banks in the systems.
4. Purchasing power parity (PPP) is an important concept in international finance.

a. What role does PPP play in understanding exchange rate behavior?

b. Suppose that you had to test whether PPP holds, describe one (of several possible) ways that you could proceed. In your answer, describe the data that you would need, the behavior that you would look for, and what you might expect to find given what you know that others have found in the past.

c. What role, if any, does PPP play in the monetary approach to the exchange rate? Demonstrate by deriving the formula for the monetary model.