

Topic 3 Review Questions

Multiple Choice Questions

1. The _____ approach to exchange rates emphasizes the role of portfolio repositioning by international financial investors.
 - a. elasticity
 - b. asset market
 - c. monetary
 - d. balance of payments

2. The asset market approach to exchange rate determination seeks to predict:
 - a. the forward exchange rate premiums.
 - b. the long-run trends in exchange rates.
 - c. the possibility of retaining a pegged exchange rate by the government.
 - d. the short-term pressures on exchange rates.

3. The exchange rate value of a foreign currency is _____ in the short run by a rise in the expected future spot exchange rate value.
 - a. raised
 - b. lowered
 - c. made volatile
 - d. not affected

4. A decrease in the foreign interest rate relative to the domestic interest rate _____ the exchange rate value of a foreign currency in the short run.
 - a. raises
 - b. lowers
 - c. does not affect
 - d. causes fluctuations in

5. Other things equal, an expected depreciation in the euro will lead to:
 - a. an inflow of capital to Europe.
 - b. an increase in official exchange market intervention by the euro area monetary authorities.
 - c. a lowering of exports of European goods and services.
 - d. a decrease in the demand for euro-denominated financial assets.

6. If the domestic interest rate decreases, with the foreign interest rate and the expected future spot rate remaining unchanged, the value of the domestic currency vis-à-vis the foreign currency is expected to:
 - a. increase.
 - b. decrease.
 - c. remain unchanged.
 - d. converge to its PPP value.

7. If the expected future spot exchange rate value of the foreign currency decreases, with the interest rate differential unchanged, the current spot exchange rate value of the domestic currency:
- increases.
 - decreases.
 - remains unchanged.
 - overshoots.
8. Which of the following statements is true?
- If the domestic interest rate rises, there will be international financial repositioning toward domestic-currency assets, thereby causing the domestic currency to appreciate.
 - If the expected future spot exchange rate value of the foreign currency decreases, there will be international financial repositioning toward foreign-currency assets, thereby causing the domestic currency to depreciate.
 - If foreign interest rates increase, the domestic interest rate remaining unchanged, there will be international financial repositioning toward domestic-currency assets and the domestic currency will appreciate.
 - If the expected future spot dollar per euro exchange rate increases, there will be international financial repositioning toward the dollar-denominated assets thereby causing the euro to depreciate.
9. Everything else remaining unchanged, an increase in interest rates in the United States is most likely to result in:
- depreciation of the dollar.
 - outflows of capital from the United States.
 - capital inflows into the United States.
 - a decrease in the demand for dollar-denominated financial assets.
10. Which of the following is NOT linked together by uncovered interest parity?
- The domestic interest rate
 - The foreign interest rate
 - The current spot exchange rate
 - The current forward exchange rate

ESSAY

11. Suppose in 1992, the average price level in Pacifica was 100, and that in Atlantica was also 100. In the foreign exchange market 1 Pacifica pound was exchanged for 1 Atlantica mark. In 2012, the price level in Pacifica had risen to 280 and the price level in Atlantica had risen to 360. According to the relative PPP theory, what should the pound-mark exchange rate be in 2012?