

## EE452 Exercise Questions (Optional)

1. What is the difference between a clean float and a managed float?
2. “The emergence of expectations that a country in the near future will impose exchange controls will probably result in upward pressure on the exchange-rate value of the country’s currency.” Do you agree or disagree? Why?
3. A country with a fixed exchange rate experiences upward pressure on the exchange rate value of its currency. The central bank chooses to intervene in the market to maintain its fixed exchange rate. How would the central bank go about intervening? If the pressures for the currency to appreciate persist, would it be difficult to maintain the fixed exchange rate? Why or why not? Would your answers differ if the country carried out sterilized intervention? Why or why not. Give an example of a country that attempted to maintain their exchange rate in the face of upward pressures on their currency value. What was the result?
4. Explain why does exchange rate overshooting occur?
5. According to the monetary approach to exchange rate determination, how would an increase in foreign real income affect the value of domestic currency? In your explanation, discuss both the quantity theory and PPP.
6. What predictions does the purchasing power parity theory make concerning the impact of domestic inflation on the home country's exchange rate? What are the limitations of the purchasing power parity theory?
7. The current spot exchange rate is \$1.14/euro. The current 90-day forward exchange rate is \$1.11/euro. How could a U.S firm, who must repay a 40 million euro loan in 90 days, use a forward exchange contract to hedge its risk exposure?
8. Suppose  $\$1 = 0.85$  euros in New York,  $1 \text{ euro} = 150$  yen in Paris, and  $1 \text{ yen} = \$0.008$  in Tokyo. If you begin by holding \$1, how could you profit from these exchange rates? What is your arbitrage profit per dollar initially traded?
9. A retailer in Mexico wants to buy \$100,000 worth of Apple computers from the United States. The Mexican retailer has pesos while the seller in the United States wants to be paid in

U.S. dollars. Explain how this transaction is completed with particular emphasis on the foreign exchange market and banks in the United States and Mexico.

10. We often hear that trade deficits are bad for a country. Do you agree or disagree with this viewpoint? Explain carefully.

11. What are the major types of transactions or activities that result in demand for foreign currency in the spot foreign exchange market?