**International Financial Markets**

**Tutorial**

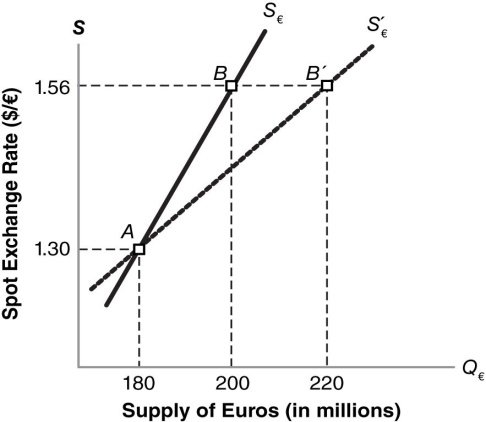
**Home Work 4**

**Balance-of-Payments and Exchange-Rate Determination**

Following are 33 questions, each worth 3 points. Indicate the answers you think most correct.

**Traditional Approaches to Balance-of-Payments and Exchange-Rate Determination**

1) Which line in the figure shows a more elastic supply for euros?



A) Line S

B) Line S'

C) There elasticities are the same.

D) This cannot be determined from the graph.

2) The approach to finding a relationship between exchange rates and the balance of payments that focuses on the prices of goods and services in the markets is

A) the elasticities approach.

B) the absorption approach.

C) the Marshall Lerner method.

D) the fixed exchange approach.

3) A necessary condition for exchange rate stability where the sum of the elasticity of import demand and the elasticity of export supply must be greater than one is known as

A) the elasticities approach.

B) the elasticities rule.

C) the Marshall Lerner condition.

D) the exchange rate condition.

4) The reason that supply and demand tend to be more price elastic over longer time periods is because

A) some goods have longer shelf life and are reordered less often.

B) it takes time for households and businesses to adjust to price changes.

C) firms incur costs in changing the price of goods on their shelves.

D) the feedback loop from buyers to sellers takes time.

5) The depreciation of a currency may cause an initial worsening of the balance of payments before it improves. This is called the

A) time value of money.

B) J-curve effect.

C) Marshall Lerner condition.

D) shock effect.

6) If a 10% currency appreciation results in a 10% decrease in the price of imported goods, then this is called

A) import inflation.

B) the Marshall Lerner condition.

C) a partial pass-through.

D) a complete pass-through.

7) Which of the following equations for domestic absorption is correct?

A) *a* ≡ *c* + *i* + *g* + *im*

B) *a* ≡ *c* + *i* + *g* + *im - x*

C) *a* ≡ *x* - *im*

D) *a* ≡ *c* + *i* + *ca* + *im*

8) If real income is 250b and the amount of domestic absorption is 322b, what is the current account balance?

A) The current account surplus is 572b.

B) The current account surplus is 72b.

C) The current account deficit is 572b.

D) The current account deficit is 72b.

9) If real income rises faster than absorption during a time of economic expansion, then

A) the nation will experience a current account deficit.

B) the nation will experience a current account surplus.

C) national production will increase until absorption and income are balanced.

D) the nation's imports must rise relative to its exports.

10) During the course of an economic contraction, it is likely that a country would experience

A) a currency depreciation as explained by the elasticities approach.

B) a currency appreciation as explained by the absorption approach.

C) a currency depreciation as explained by the absorption approach.

D) a currency appreciation as explained by the elasticities approach.

11) The government's ability to alter expenditures in its economy between imports and exports by enacting policies to change their relative prices is known as

A) expenditure-switching instruments.

B) trade drivers.

C) tariff tools.

D) absorption instruments.

12) If real income rises faster than absorption during a time of economic expansion, then

A) the currency should depreciate.

B) the nation's exports must rise relative to its imports.

C) the nation will experience a current account deficit and a capital account surplus.

D) absorption spending will continue to slow.

13) The quantity demanded of a currency in the foreign exchange market is derived from

A) the level of domestic absorption.

B) the nation's demand for exports.

C) the nation's demand for imports.

D) the supply of other currencies.

**Monetary and Portfolio Approaches to Balance-of-Payments and Exchange-Rate Determination**

1) Which of the following statements is true about sovereign funds?

A) They are usually held in assets denominated in foreign currencies.

B) They are nearly three times the size of the U.S. national income.

C) They are larger than the total assets held by China, Korea, Russia, and Singapore.

D) They have been diminishing in size over the last decades.

2) The sum of currency and bank reserves held by the central bank is one way of calculating

A) the money multiplier.

B) the monetary base.

C) the domestic portfolio.

D) domestic credit.

3) A nation's FER \_\_\_\_\_\_\_\_

A) stands for foreign exchange reserves.

B) is valued in terms of domestic currency.

C) can used to intervene in currency markets.

D) all of the above

4) The monetary base can be calculated as:

A) DC + FER + C + TR.

B) DC + TR.

C) C + FER.

D) DC + FER.

5) If domestic credit were $12 million and foreign exchange reserves were $26 million and the reserve requirement were 10%, what is the value of the money stock?

A) $38.1 million$

B) 380 million

C) $140 million

D) $14 million

6) Suppose that the Federal Reserve issued bonds in the amount of $45 million and the reserve requirement was 10%, what would be the resulting change to the monetary base?

A) $45 million

B) $450 million

C) $4.5 million

D) The bond issuance would not impact the monetary base only the money stock.

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8) When a central bank intervenes in the \_\_\_\_\_\_\_\_, their intention is to \_\_\_\_\_\_\_\_.

A) swap markets, convey a clear signal to the markets

B) futures market, hide its actions from the markets

C) forward market, hide its actions from the markets

D) spot market; convey a clear signal to the markets

9) If a central bank is said to be leaning against the wind, they have signaled that they will

A) intervene to reverse the current trend of their currency.

B) intervene to accelerate the current trend of their currency.

C) not intervene in the currency markets at all.

D) work together with their opposition even if it is politically difficult.

10) If an economy has a fixed exchange rate and it chooses to issue $10 million in bonds, what will happen according to the Monetary approach?

A) It will have to increase its foreign exchange reserves.

B) It will have to decrease its foreign exchange reserves.

C) It will have to allow its currency to appreciate.

D) It will have to allow its currency to depreciate.

**An Open Economy Framework**

1) If real GDP were $9300 and nominal GDP were $11,160, then the GDP deflator would be

A) 1.2.

B) 120.

C) 1860.

D) 1.86.

2) The GDP price deflator is a

A) flexible-weight price index.

B) fixed-weight price index.

C) base-less price index.

D) base year comparison.

3) The CPI is consider a \_\_\_\_\_\_\_\_ because \_\_\_\_\_\_\_\_.

A) flexible-weight price index; it uses a variable basket of goods

B) fixed-weight price index; it uses a fixed basket of goods

C) non-weighted price index; it doesn't weigh the prices of the goods

D) fixed-year index; it uses only one year's worth of data for comparison.

4) The real income identity includes all of the following EXCEPT

A) real savings.

B) real exports.

C) real consumption.

D) real net taxes.

5) Which of the following is not part of the product identity?

A) real realized investment spending

B) real government spending

C) real exports

D) real savings

6) A rise in the nominal interest rate would cause

A) a decline in desired investment spending.

B) a downward shift in aggregate desired expenditures.

C) a movement along the IS curve.

D) all of the above.

7) If the price level decreases

A) the LM curve will shift to the right.

B) the LM curve will shift to the left.

C) the IS curve will shift to the right.

D) the IS curve will shift to the left.

8) The balance of payments is in equilibrium when

A) the sum of the current account balance and capital account balance is zero.

B) net exports are zero.

C) net foreign investment is zero.

D) real foreign investment is equal to net exports.

9) If the intersection of the IS and LM schedules lies above the BP curve, then

A) the three curves are in equilibrium

B) there is a balance of payments deficit.

C). there is a balance of payments surplus.

D) net foreign investment is decreasing.

10) If the BP curve sits above the intersection of IS and LM, then

A) the real interest rate and the real income levels are too high resulting in a balance of payments surplus.

B) the nominal interest rate and the real income levels are inconsistent with a balance of payments equilibrium.

C) real money demand is not equal to real income balances.

D) real income balances are greater than real trade balances.