Matr.-Nr. ________________ **Name:** ________________________

Examination	**International Macroeconomics and Finance (No. 1293)**
Examiners:	**Prof. Dr. Gerhard Schwödiauer/ Dr. Ludwig von Auer**
Semester:	**Winter Semester 2002/03**
The following aids may be used:	**Non-programmable pocket calculators; English language dictionaries without any marking.**

This exam comprises <u>25 problems</u>. For each problem <u>exactly one</u> of the <u>three optional answers</u> is correct. Do not mark more than one answer to any of the questions, otherwise the solution will be considered false. For every correct answer you obtain 2 points, for every false answer 1 point is subtracted. If no answer is marked you neither obtain nor lose a point. In order to pass this exam <u>at least 20 points</u> are needed.

Make sure that this copy of the exam bears your <u>matriculation number</u> and <u>name</u> in the appropriate fields at the top of this page!

<u>Examination Questions:</u>

1. In period t an effective appreciation of the euro is recorded if

   ☐ a) the share of a major trading partner of the euro-area in the euro-area's foreign trade, whose currency has not depreciated via-a-vis the euro, has increased;

   ☐ b) the euro has appreciated in terms of the currencies of some trading partners while not depreciating against the others;

   ☐ c) the price level of the euro-area's exports has increased relative to the price levels in the rest of the world.

2. The real exchange rate of some country is said to rise if

   ☐ a) for unchanged nominal exchange rates, its inflation rate over the last year has been higher than the inflation rate in the rest of the world;

   ☐ b) for unchanged nominal exchange rates, its inflation rate has been lower than the other countries' inflation rates;

   ☐ c) the country's terms of trade have worsened over the last year.

3. The markets pay a forward premium on the euro of 2 % if

- ☐ a) the forward dollar-price of the euro exceeds the respective spot price by 2 % of the forward price;
- ☐ b) the current forward euro-price of the dollar is 2 % above the latter's current spot price;
- ☐ c) the current spot dollar-price of the euro exceeds the current forward price by 2 % of the spot price.

4. Assume that the current spot exchange rate of the euro is 1.05 \$. The interest rate on 12-months dollar deposits is 1.5 % p. a., on 12-months euro deposits it is 3 % p. a. The CIP condition requires the 12-months forward rate of the euro to be approximately

- ☐ a) 0.940 \$;.
- ☐ b) 1.035 \$;
- ☐ c) 1.060 \$.

5. The Relative Purchasing Power Parity hypothesis claims that

- ☐ a) in the long run the dollar exchange rate of the euro will be close to the ratio of the purchasing power of 1 euro (in the euro-area) to the purchasing power of 1 dollar (in the US);
- ☐ b) in the absence of non-monetary shocks, the percentage depreciation of the euro in terms of the dollar will in the longer run be close to the difference between the inflation rate in the euro-area and the US inflation rate;
- ☐ c) the real euro-dollar-exchange rate does not change in the long run.

6. When Israel's annual inflation rate exceeded 100 % in the early 1980s, Israelis took to quoting domestic transactions prices in US dollars and converting them to Israeli currency at the exchange rate of the moment. Does this behavior illustrate

- ☐ a) the convenience of using vehicle currencies?
- ☐ b) the undesirability of holding a fast-depreciating currency?
- ☐ c) the transaction costs of adjusting price quotations for rapid inflation?

7. When the spot exchange rate of the euro was 0.85 \$, you have bought an "American" call option on euros with a strike price of 1 \$. The only rational decision

- ☐ a) would have been to exercise your option when the euro reached a value of 1 \$;
- ☐ b) would be to exercise your option now if the contract is presently about to expire;
- ☐ c) would be to exercise your option now if the contract still has two months to run.

8. Central bank intervention in the foreign exchange market means that the domestic monetary authority

- [ ] a) requires exporters to hand over foreign currency revenues at the official exchange rate;
- [ ] b) buys in the foreign exchange market foreign currency if it is in excess supply at the current exchange rate;
- [ ] c) imposes proper regulations on the trading in foreign currencies within its own jurisdiction.

9. Under the gold exchange standard every central bank is committed to converting its bank notes

- [ ] a) into gold at a fixed parity on the demand of any bearer;
- [ ] b) into gold at a fixed parity on the demand of another central bank belonging to the system;
- [ ] c) into another currency, which is freely convertible into gold, on the demand of any bearer of its bank notes.

10. Assume that the period under consideration is short enough to rule out any feedback of changes in the exchange rate on other determinants of supply of and demand for foreign currency. Without any government intervention an equilibrium of the foreign exchange market is stable with respect to small shocks if and only if

- [ ] a) export as well as import demand price elasticities are positive;.
- [ ] b) the import demand price elasticity is bigger than 1;
- [ ] c) the sum of import and export price elasticities is bigger than 1.

11. In the German balance-of-payments accounts (where exports are credits, and imports debits), the purchase of a controlling stake in an American company by a German firm for euros in cash affects

- [ ] a) the unilateral-transfers account on the debit and the short-term capital account on the credit side;
- [ ] b) the long-term capital account on the debit and the short-term capital account on the credit side;
- [ ] c) the short-term capital account on the debit and the long-term capital account on the credit side.

12. The repatriation of profits by a German company from its British subsidiary in pounds is

- [ ] a) a debit on the short-term capital account and a credit on the long-term capital account;
- [ ] b) a credit on the current account and a debit on the short-term capital account;
- [ ] c) a credit on the current account and a debit on the ORT account.

13. Assume that the value of exports in domestic currency is 10 billion €, while the value of imports is 30 billion €. The price elasticity of exports is 0.6, that of imports 0.7. A devaluation of the domestic currency will

- ☐ a) improve the trade balance;
- ☐ b) worsen the trade balance;
- ☐ c) have no influence on the trade balance.

14. For the situation described in problem 13, express the country's trade balance in foreign currency. A devaluation of the domestic currency will then

- ☐ a) improve the trade balance;
- ☐ b) worsen the trade balance;
- ☐ c) not change the trade balance.

15. At a given exchange rate, an excess supply of domestic currency obtains if

- ☐ a) the sum of domestic current and long-term capital account balances is positive;
- ☐ b) the sum of domestic current, short-term and and long-term capital accounts is negative;
- ☐ c) the official reserve transactions balance is negative.

16. Assume that for a given exchange rate and a given level of public expenditure a small open economy suffers from a trade balance deficit and an underemployment level of GDP. In order to restore full employment and a zero trade balance, an appropriate policy mix (if the ML-condition holds) may be

- ☐ a) a devaluation of the domestic currency and a cut in government expenditure;
- ☐ b) a revaluation of the domestic currency and an increase in government expenditure;
- ☐ c) an increase in government expenditure without a change in the exchange rate.

17. Suppose that the government wishes to minimize the fluctuations of domestic real GDP in the presence of fluctuating domestic investment and volatile foreign demand for domestic output. Which exchange rate regime would be preferable if the volatility of investment is much smaller than that of foreign demand?

- ☐ a) Fixed exchange rates.
- ☐ b) Flexible exchange rates.
- ☐ c) Does not matter.

18. For flexible exchange rates, a sizeable Laursen-Metzler-Harberger effect

- [ ] a) supports the insulation against foreign demand shocks;
- [ ] b) enhances the impact on domestic GDP of an expansionary monetary policy;
- [ ] c) unambiguously reduces the impact of an expansionary fiscal policy. on domestic GDP.

19. For a small open economy a devaluation of its currency will have

- [ ] a) a contracting effect on short-run aggregate supply (SAS);.
- [ ] b) an expansionary effect on SAS;
- [ ] c) no impact on SAS.

20. A sterilization operation by the central bank aims at

- [ ] a) keeping the domestic interest rate constant;
- [ ] b) keeping the exchange rate constant;
- [ ] c) keeping the monetary base constant.

21. Under conditions of low capital mobility, the effect of a cut in taxes on domestic effective demand

- [ ] a) is stronger if the monetary authorities keep the exchange rate fixed than for a floating exchange rate;
- [ ] b) is stronger if the exchange rate is freely floating than in the case of a fixed exchange rate;
- [ ] c) does not depend on the exchange rate policy rule.

22. Assume that a small member country of the European Monetary Union experiences a domestic investment boom. As a consequence, without any policy response, the upward pressure on the domestic price level

- [ ] a) is stronger than it would be if the country were not member of EMU and let its exchange rate float;
- [ ] b) is weaker than it would be in the case of non-membership in EMU and floating exchange rate;
- [ ] c) does not depend on the country being member of EMU or not.

23. Under conditions of high capital mobility and floating exchange rates, the expansionary effect of a rise in government expenditure on domestic GDP is

- ☐ a) bigger if exchange rate expectations are regressive than if they are static;
- ☐ b) bigger if the exchange rate expectations are extrapolative than if they are static;
- ☐ c) smaller if exchange rate expectations are regressive than if they are . extrapolative.

24. For floating exchange rates, a domestic monetary expansion

- ☐ a) does not affect domestic aggregate demand;
- ☐ b) will always increase domestic aggregate demand;
- ☐ c) will increase domestic aggregate demand only under conditions of high capital mobility.

25. A rise in the foreign interest rate will have an expansionary effect on domestic GDP

- ☐ a) whenever there is some international capital mobility;
- ☐ b) only in a regime of floating exchange rates;
- ☐ c) only in a regime of fixed exchange rates.