Chapter 2: Introduction to Exchange Rates and the Foreign Exchange Market

---

131 **Exchange rates affect:**

- **international trade flows.** *Incorrect*
- **international investment flows.** *Incorrect*
- **corporate earnings.** *Incorrect*
- **All of the above are affected.** *(True Answer)Correct*

---

132 **The price of a foreign currency expressed in terms of the home currency is called:**

- **the exchange rate.** *(True Answer)Correct*
- **the rate of depreciation.** *Incorrect*
- **the dollar/yen ratio.** *Incorrect*
- **the opportunity cost.** *Incorrect*

---

133 **Normally, exchange rates are expressed as:**

- **the number of units of the currency per one ounce of gold.** *Incorrect*
- **the GDP of one nation as a percentage of the GDP of the other.** *Incorrect*
- **the price of one unit of foreign currency expressed in terms of the domestic currency.** *(True Answer)Correct*
- **ratios of the value of one nation's wealth compared to the other.** *Incorrect*

---

134 **To keep things straight and avoid confusion, it is important to:**

- **know exactly what the exchange rate signifies in terms of which currency is the denominator.** *(True Answer)Correct*
- **watch for ways the currency might lose value.** *Incorrect*
- **learn about recent behavior of the exchange rate.** *Incorrect*
- **know exactly what the rate is at any moment in**

time. *Incorrect*

---

135 **The notation for the euro/dollar exchange rate is:**

- **$FX_{€/\$}$.** *Incorrect*
- **$FX_{\$/€}$.** *Incorrect*
- **$E_{€/\$}$**

(True Answer)Correct

- **$E_{\$/€}$.** *Incorrect*

---

136 **Generally, exchange rates are quoted as a single price of a unit of foreign currency rather than a ratio because:**

- **the ratio of the units of home currency to units of foreign currency is always equal to one.** *Incorrect*
- **the denominator is always equal to 1.** *(True Answer)Correct*
- **the price is fixed by the government.** *Incorrect*
- **the rate is adjustable in increments of 25 basis points.** *Incorrect*

---

137 **The equation $E_{\$/£} = 2$ means that:**

- **1 dollar buys 2 pounds.** *Incorrect*
- **1 dollar buys of a pound.** *(True Answer)Correct*
- **2 pounds buy 1 dollar.** *Incorrect*
- **1 dollar buys 1 pound.** *Incorrect*

---

138 **If the dollar-euro exchange rate on June 30, 2010, is $1.225 per euro, then the euro-dollar exchange rate would be:**

- **€2.45 per dollar.** *Incorrect*
- **€0.816 per dollar.** *(True Answer)Correct*
- **€1.225 per dollar.** *Incorrect*
- **€1 per dollar.** *Incorrect*

---

139 **The equation $E_{¥/£} = 10$ means that:**

- **1 yen buys 10 pounds.** *Incorrect*
- **0.1 yen buys 1 pound.** *Incorrect*
- **10 yen buy 1 pound.** *(True Answer)Correct*
- **0.01 yen buys 1 pound.** *Incorrect*

---

140 **If we compare the exchange rate between two nations, expressed in the domestic currency with the same rate expressed in units of the foreign currency, it will be obvious that:**

- **they are both equal to 1.** *Incorrect*
- **they cancel each other out.** *Incorrect*
- **one is always the reciprocal of the other.** *(True Answer)Correct*
- **they can never coexist.** *Incorrect*

---

141 **If, in 2000, $1 = 1.5 euro, and in 2007, $1 = 0.9 euro, which of the following statements would be true?**

- **More American tourists will find it cheaper to travel to Europe.** *Incorrect*
- **More Europeans will stay home as visits to the United States become more expensive.** *Incorrect*
- **Europeans will import fewer products from the United States.** *Incorrect*
- **Americans will import fewer products from Europe.** *(True Answer)Correct*

---

142 **A dining table costs $3,000 in New York and the same table costs 5,000 euros in Rome. Thus, $1 is equal to:**

- **1 euro.** *Incorrect*
- **2 euros.** *Incorrect*
- **1.67 euros.** *(True Answer)Correct*
- **0.6 euro.** *Incorrect*

---

143 **Table: Exchange Rates across Currencies**

Country	Price per dollar (January 1, 2006)
Canada	$1.2
Japan	120 yen
Mexico	12 pesos
India	45 rupees

Reference: Ref 2-1

(Table: Exchange Rates across Currencies) If the exchange rate on January 1, 2007, is $1 = 144 yen, then:

- **the dollar has appreciated 10% against the yen.** *Incorrect*
- **the dollar has depreciated 24% against the yen.** *Incorrect*

- **the yen has depreciated 12% against the dollar.** *Incorrect*
- **the yen has depreciated 20% against the dollar.** *(True Answer)Correct*

---

144 **Table: Exchange Rates across Currencies**

Country	Price per dollar (January 1, 2006)
Canada	$1.2
Japan	120 yen
Mexico	12 pesos
India	45 rupees

Reference: Ref 2-1

(Table: Exchange Rates across Currencies) Based on the information provided, which of the following statements is true?

- **1 peso = 10 yen.** *(True Answer)Correct*
- **1 rupee = 10 yen.** *Incorrect*
- **1 peso = 3 rupees.** *Incorrect*
- **$1 Canadian = 35 rupees.** *Incorrect*

---

145 **Table: Exchange Rates across Currencies**

Country	Price per dollar (January 1, 2006)
Canada	$1.2
Japan	120 yen
Mexico	12 pesos
India	45 rupees

Reference: Ref 2-1

(Table: Exchange Rates across Currencies) Based on the information provided, 1 Canadian dollar is equal to _____ Mexican pesos and _____ Indian rupees.

- **12; 73.5** *Incorrect*
- **10; 37.5** *(True Answer)Correct*
- **12; 37.5** *Incorrect*
- **12; 45** *Incorrect*

---

146 **If a nation's currency buys fewer units of a foreign currency today than yesterday, we say the value of its currency has:**

- **appreciated.** *Incorrect*

- **depreciated.** *(True Answer)Correct*
- **stagnated.** *Incorrect*
- **become inverted.** *Incorrect*

---

147 **If today €1 exchanges for ¥135, and tomorrow €1 exchanges for ¥150, we say the euro has:**

- **appreciated.** *(True Answer)Correct*
- **depreciated.** *Incorrect*
- **stagnated.** *Incorrect*
- **become inverted.** *Incorrect*

---

148 **When a nation's currency appreciates, it purchases _____ units of a foreign currency and it is said to _____.**

- **fewer; strengthen** *Incorrect*
- **more; strengthen** *(True Answer)Correct*
- **fewer; weaken** *Incorrect*
- **more; weaken** *Incorrect*

---

149 **If one nation's currency strengthens against a foreign currency, the other nation's currency must _____ against the domestic currency.**

- **strengthen** *Incorrect*
- **equalize** *Incorrect*
- **weaken** *(True Answer)Correct*
- **appreciate** *Incorrect*

---

150 **When the dollar declines in value against a foreign currency, it is called:**

- **an appreciation.** *Incorrect*
- **a depreciation.** *(True Answer)Correct*
- **an inflation.** *Incorrect*
- **a deflation.** *Incorrect*

---

151 **In European terms, when the exchange rate for the U.S. dollar increases:**

- **the dollar has appreciated.** *(True Answer)Correct*
- **the dollar has depreciated.** *Incorrect*
- **the euro has appreciated.** *Incorrect*
- **the dollar has weakened.** *Incorrect*

---

152 **Which of the following statements are equivalent to an appreciation of the dollar relative to the euro?**

- **The dollar buys more euros now.** *Incorrect*
- **The euro buys fewer dollars now.** *Incorrect*
- **The dollar buys more euros now, and the euro buys fewer dollars now.** *(True Answer)Correct*
- **The euro buys more dollars now.** *Incorrect*

---

153 **Ironically, when the dollar "cost" of a unit of foreign currency falls, the dollar is actually _____ against the foreign currency.**

- **depreciating** *Incorrect*
- **appreciating** *(True Answer)Correct*
- **equalizing** *Incorrect*
- **holding its own** *Incorrect*

---

154 **If a euro costs $1.25 today, and it costs $1.50 tomorrow, what has happened to the dollar-euro exchange rate?**

- **The dollar has depreciated and the euro has depreciated.** *Incorrect*
- **The dollar has appreciated and the euro has depreciated.** *Incorrect*
- **The dollar has depreciated and the euro has appreciated.** *(True Answer)Correct*
- **The dollar has appreciated and the euro has appreciated.** *Incorrect*

---

155 **It is customary to express changes in the exchange rates of two currencies over time as:**

- **the loss of purchasing power of one currency divided by the loss of purchasing power of the other currency.** *Incorrect*
- **the percentage change expressed as an appreciation or depreciation of one against the other.** *(True Answer)Correct*
- **a ratio of the absolute values (without signs).** *Incorrect*
- **a ratio of the price of gold in each nation.** *Incorrect*

---

156 **In general, the percentage of appreciation of one nation's currency is equal to:**

- **its rate of growth of real GDP.** *Incorrect*
- **its purchasing power.** *Incorrect*
- **its population growth.** *Incorrect*

- **the percentage of depreciation of the foreign nation's currency.** *(True Answer)Correct*

---

157 **Slight discrepancies in the rates of appreciation versus depreciation of two currencies are related to:**

- **a mathematical quirk that percentage increases are always larger than percentage decreases because in the first case the denominator is smaller.** *(True Answer)Correct*
- **the imprecise nature of the calculations.** *Incorrect*
- **the lack of reliable information.** *Incorrect*
- **the volatile nature of exchange rates.** *Incorrect*

---

158 **Changes in exchange rates are usually expressed in percentage terms. The percentage rate of appreciation for one currency will be close to the rate of depreciation for the other nation whenever:**

- **the change in the rate is very small.** *(True Answer)Correct*
- **the exchange rates are very different in quantitative terms.** *Incorrect*
- **the change in the rate is very large.** *Incorrect*
- **one exchange rate is 50% more than the other one at the time of the change.** *Incorrect*

---

159 **If $E_{\$/£}$ moves from 2 to 3, this is a percentage change of:**

- **50%.** *(True Answer)Correct*
- **33.3%.** *Incorrect*
- **–33.3%.** *Incorrect*
- **–50%.** *Incorrect*

---

160 **If $E_{\$/£}$ increases by 20%, this is consistent with:**

- **an increase from 4 to 5.** *Incorrect*
- **an increase from 4 to 6.** *Incorrect*
- **an increase from 5 to 6.** *(True Answer)Correct*
- **an increase from 4 to 7.** *Incorrect*

---

16 1 **Table: Currency Values I**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais

$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-2

(Table: Currency Values I) The U.S. dollar appreciated against the _____.

- **Mexican peso and Japanese yen.** *(True Answer)Correct*
- **Mexican peso and Indian rupee.** *Incorrect*
- **euro and Japanese yen.** *Incorrect*
- **euro and the Indian rupee.** *Incorrect*

---

162 **Table: Currency Values I**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-2

(Table: Currency Values I) The U.S. dollar depreciated against the _____ and the _____.

- **euro; Indian rupee** *(True Answer)Correct*
- **Indian rupee; Japanese yen** *Incorrect*
- **Mexican peso; Japanese yen** *Incorrect*
- **euro; Japanese yen** *Incorrect*

---

163 **Table: Currency Values I**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-2

(Table: Currency Values I) The U.S. dollar appreciated against the peso by _____.

- **2.4%** *Incorrect*
- **24%** *(True Answer)Correct*
- **10%** *Incorrect*
- **12.4%** *Incorrect*

164 **Table: Currency Values I**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-2

(Table: Currency Values I) The U.S. dollar depreciated against the euro by _____.

- **0.6%** *Incorrect*
- **1%** *Incorrect*
- **40%** *(True Answer)Correct*
- **100%** *Incorrect*

165 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) The dollar appreciated against which currencies?

- **the euro** *Incorrect*
- **the real** *Incorrect*
- **the pound and the rupee** *(True Answer)Correct*
- **the euro and the pound** *Incorrect*

166 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) The dollar depreciated against which currencies?

- **the euro** *Incorrect*
- **the real** *Incorrect*
- **the pound** *Incorrect*
- **the euro and the real** *(True Answer)Correct*

---

167 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) The dollar rose against the rupee by _____.

- **111%** *Incorrect*
- **11%** *(True Answer)Correct*
- **1%** *Incorrect*
- **–1%** *Incorrect*

---

168 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) The dollar depreciated against the euro by _____.

- **–33%** *Incorrect*
- **3%** *Incorrect*
- **33%** *(True Answer)Correct*

- **50%** *Incorrect*

---

169 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) In 2007, how many euros would it take to buy 1 pound?

- **0.75** *(True Answer)Correct*
- **1.33** *Incorrect*
- **1.5** *Incorrect*
- **3** *Incorrect*

---

170 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) Between 2007 and 2008, how did the euro do against the British pound?

- **It appreciated.** *(True Answer)Correct*
- **It held steady.** *Incorrect*
- **It depreciated.** *Incorrect*
- **Not enough information is provided to know how well the euro did.** *Incorrect*

---

171 **Table: Currency Values II: How Much 1 U.S. Dollar Will Buy of Other Currencies in 2007 and 2008**

Currency	2007	2008
$1	1.5 euros	1 euro

$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-3

(Table: Currency Values II) All else being equal, if you want to invest dollars in 2007 and then convert them back into dollars in 2008, which is the best currency to invest in?

- **the euro** *(True Answer)Correct*
- **the real** *Incorrect*
- **the pound** *Incorrect*
- **the rupee** *Incorrect*

---

172 **A bilateral exchange rate is:**

- **an exchange rate that has two sides: maximal and minimal.** *Incorrect*
- **an exchange rate that has exhibited both appreciation and depreciation.** *Incorrect*
- **an exchange rate that is a hybrid between fixed and floating.** *Incorrect*
- **an exchange rate between two currencies.** *(True Answer)Correct*

---

173 **What is a multilateral exchange rate?**

- **It is an exchange rate that is measured by using a number of different techniques.** *Incorrect*
- **It is an exchange rate that calculates the overall movement of the rate against more than just one other currency.** *(True Answer)Correct*
- **It is an exchange rate that is measured once every 10 years.** *Incorrect*
- **It is a rate that is set by the IMF for many different nations.** *Incorrect*

---

174 **The average of the bilateral rate changes for a nation, weighted by the importance of the trading partner, is known as:**

- **the real exchange rate.** *Incorrect*
- **the nominal exchange rate.** *Incorrect*

- **the effective exchange rate.** *(True Answer)Correct*
- **the direct exchange rate.** *Incorrect*

---

175 **To calculate the multilateral effective exchange rate for a nation for each trading partner:**

- **add the share of trade to the % change in the exchange rate and add the sums.** *Incorrect*
- **divide the share of trade by the % change in the exchange rate and add the dividends.** *Incorrect*
- **subtract the share of trade from the % change in the exchange rate and add the differences.** *Incorrect*
- **multiply the share of trade by the change in the exchange rate and add the products.** *(True Answer)Correct*

---

176 **Your textbook refers to a "basket" of currencies. What is it?**

- **a random selection of currencies** *Incorrect*
- **currencies that are low-valued and unstable** *Incorrect*
- **currencies that represent the average increase in value for all currencies** *Incorrect*
- **currencies most used by the nation in its trade and other transactions, weighted by their importance** *(True Answer)Correct*

---

177 **We use the effective exchange rate calculation to tell us:**

- **the underlying rate of inflation.** *Incorrect*
- **how international finance affects a nation's exchange rate.** *Incorrect*
- **how the overall international purchasing power of a nation has changed.** *(True Answer)Correct*
- **the natural (real) exchange rate taking out the effects of inflation.** *Incorrect*

---

178 **Suppose 80% of U.S. trade is with England and the rest is with Japan. If the dollar rises by 10% against the pound and rises by 20% against the yen, what is the percentage change in the effective exchange rate of the United States?**

- **–16%** *Incorrect*
- **–12%** *(True Answer)Correct*
- **–8%** *Incorrect*

- **–4%** *Incorrect*

---

179 **Suppose 60% of U.S. trade is with England and the rest is with Japan. If the dollar rises by 20% against the pound but falls by 20% against the yen, what is the percentage change in the effective exchange rate of the United States?**

- **–12%** *Incorrect*
- **–4%** *(True Answer)Correct*
- **±0%** *Incorrect*
- **–8%** *Incorrect*

---

180 **If the dollar falls by 20% against the euro and rises by 10% against the yen, which of the following values for European and Japanese trade with the United States are consistent with a 10% increase in the effective exchange rate of the United States?**

- **Europe: 33%; Japan: 66%** *Incorrect*
- **Europe: 66%; Japan: 33%** *Incorrect*
- **Europe: 50%; Japan: 50%** *Incorrect*
- **None of the answer choices is correct.** *(True Answer)Correct*

---

181 **The U.S. dollar's effective exchange rate since 2002 has steadily declined. However, that decline was not as steep against all major currencies as it was with the well-known major currencies because:**

- **the U.S. government has a strong dollar policy.** *Incorrect*
- **the large trading partners, China and Japan, did not allow their currencies to appreciate greatly against the U.S. dollar.** *(True Answer)Correct*
- **the rate of appreciation is always somewhat greater than the rate of depreciation.** *Incorrect*
- **the United States does not trade with some nations, so the effective rate is biased.** *Incorrect*

---

182 **When exchange rates change and prices stay the same:**

- **relative prices of traded goods in the two nations change.** *Incorrect*
- **the price of foreign goods expressed in the home currency will change.** *Incorrect*
- **imports get more expensive as the home currency depreciates.** *Incorrect*

- **All of the answers are correct.** *(True Answer)Correct*

---

183 **The fall in the U.S. dollar has not affected Chinese trade as much as that for other countries because:**

- **China has appreciated its currency.** *Incorrect*
- **China has reduced its exports.** *Incorrect*
- **China has depreciated its currency.** *Incorrect*
- **China has pegged its currency to the dollar.** *(True Answer)Correct*

---

184 **Using exchange rates, it is possible to price-compare in different nations. If an iPod costs $90 in the United States and €45 in France, in which nation would you get the better deal? The dollar-euro exchange rate is now $2/€.**

- **The iPod would be cheaper in France.** *Incorrect*
- **The iPod would be cheaper in the United States.** *Incorrect*
- **The iPod would cost the same in both countries.** *(True Answer)Correct*
- **From the information provided, it is impossible to answer this question.** *Incorrect*

---

185 **Using exchange rates, it is possible to price-compare in different nations. If an iPod costs $90 in the United States and €45 in France, in which nation would you get the better deal? The dollar-euro exchange rate is now $2.50/€.**

- **The iPod would be cheaper in France.** *Incorrect*
- **The iPod would be cheaper in the United States.** *(True Answer)Correct*
- **The iPod would cost the same in both countries.** *Incorrect*
- **From the information provided, it is impossible to answer this question.** *Incorrect*

---

186 **In general, when a nation's currency depreciates, goods priced in foreign currencies:**

- **become cheaper.** *Incorrect*
- **become more expensive.** *(True Answer)Correct*
- **are not affected.** *Incorrect*
- **either become more or less expensive depending on the value of the currency in that nation.** *Incorrect*

---

187 **In general, when a nation's currency appreciates, goods priced in foreign currencies:**

- **become cheaper.** *(True Answer)Correct*
- **become more expensive.** *Incorrect*
- **are not affected.** *Incorrect*
- **either become more or less expensive, depending on the value of the currency in that nation.** *Incorrect*

---

188 **A depreciation of the dollar will benefit:**

- **a firm that sells in the United States but produces in Japan.** *Incorrect*
- **a firm that sells in the United States and produces in the United States.** *Incorrect*
- **a firm that produces in the United States and sells in Japan.** *(True Answer)Correct*
- **no domestic producers.** *Incorrect*

---

189 **An appreciation of the dollar will benefit:**

- **a firm that sells in the United States but produces in Japan.** *(True Answer)Correct*
- **a firm that sells in the United States and produces in the United States.** *Incorrect*
- **a firm that produces in the United States and sells in Japan.** *Incorrect*
- **no foreign consumers.** *Incorrect*

---

190 **When the dollar depreciates, which of the following is unlikely to happen?**

- **German consumers will buy more U.S. products.** *Incorrect*
- **U.S. consumers will find German goods to be more expensive.** *Incorrect*
- **Chinese consumers will not buy U.S. goods.** *(True Answer)Correct*
- **Americans will not travel abroad as much for vacations.** *Incorrect*

---

191 **Imports from Europe to the United States have risen. This suggests that:**

- **the dollar has depreciated.** *Incorrect*
- **the euro has appreciated.** *Incorrect*
- **the dollar has appreciated.** *(True Answer)Correct*
- **the euro has depreciated.** *Incorrect*

---

192 **Exports from Australia to Brazil have increased. This suggests that the Australian dollar:**

- **has appreciated against the Brazilian real.** *Incorrect*
- **has depreciated against the Brazilian real.** *(True Answer)Correct*
- **has not changed.** *Incorrect*
- **has appreciated against all currencies except the Brazilian real.** *Incorrect*

---

193 **If the euro depreciates relative to the dollar but does not change relative to the pound, then one might expect:**

- **Europeans to import more from the United States and less from the United Kingdom.** *Incorrect*
- **Europeans to export more to the United States and the same amount to the United Kingdom.** *Incorrect*
- **Europeans to import less from the United States and the same amount from the United Kingdom.** *(True Answer)Correct*
- **Europeans to import more from the United States and more from the United Kingdom.** *Incorrect*

---

194 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) In 2007, a product that costs $50 should cost:

- **57 euros.** *Incorrect*
- **25 reais.** *Incorrect*
- **100 pounds.** *(True Answer)Correct*
- **450 rupees.** *Incorrect*

195 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) In 2008, a good that costs 60 pounds should cost:

- **60 reais.** *Incorrect*
- **30 reais.** *(True Answer)Correct*
- **20 reais.** *Incorrect*
- **10 reais.** *Incorrect*

196 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) From 2007 to 2008, the U.S. dollar rose against the pound by _____.

- **50%** *(True Answer)Correct*
- **25%** *Incorrect*
- **10%** *Incorrect*
- **0%** *Incorrect*

197 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) In 2007, the dollar-real exchange rate is:

- **0.2.** *Incorrect*
- **0.15.** *Incorrect*
- **0.66.** *Incorrect*
- **0.5.** *(True Answer)Correct*

---

198 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) In 2008, the dollar-pound exchange rate is:

- **0.33.** *(True Answer)Correct*
- **0.5.** *Incorrect*
- **0.2.** *Incorrect*
- **0.3.** *Incorrect*

---

199 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) If the United States imports trades in equal amounts with all four countries, then the percentage change in the U.S. effective exchange rate from 2007 to 2008 is approximately:

- **50%.** *Incorrect*
- **20%.** *Incorrect*
- **–20%.** *Incorrect*
- **–1.5%.** *(True Answer)Correct*

---

200 **Table: Currency Values II**

Currency	2007	2008

$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) If there are no arbitrage possibilities, then the pound-euro exchange rate in 2008 is:

- **3.** *(True Answer)Correct*
- **1.33.** *Incorrect*
- **66.** *Incorrect*
- **33.** *Incorrect*

---

201 **Table: Currency Values II**

Currency	2007	2008
$1	1.5 euros	1 euro
$1	2 Brazilian reais	1.5 Brazilian reais
$1	2 British pounds	3 British pounds
$1	45 Indian rupees	50 Indian rupees

Reference: Ref 2-4

(Table: Currency Values II) If there are no arbitrage possibilities, then the pound-real exchange rate in 2007 is:

- **2.** *(True Answer)Correct*
- **1.** *Incorrect*
- **5.** *Incorrect*
- **3.** *Incorrect*

---

202 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) In 2001, a product that costs $10 should cost:

- **16.66 euros.** *Incorrect*
- **6 euros.** *Incorrect*
- **40 rupees.** *Incorrect*
- **None of the answer choices is correct.** *(True Answer)Correct*

---

203 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) In 2002, a good that costs 10 euros should cost:

- **16.66 dollars.** *(True Answer)Correct*
- **10 dollars.** *Incorrect*
- **6 dollars.** *Incorrect*
- **3 dollars.** *Incorrect*

---

204 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) From 2001 to 2002, the U.S. dollar fell against:

- **the euro.** *Incorrect*
- **the real.** *Incorrect*
- **the pound.** *Incorrect*
- **None of the answer choices is correct.** *(True Answer)Correct*

---

205 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais

$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) In 2001, the dollar-pound exchange rate is:

- **75.** *Incorrect*
- **1.33.** *(True Answer)Correct*
- **1.5.** *Incorrect*
- **5.** *Incorrect*

---

206 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) In 2002, the dollar-rupee exchange rate is:

- **33.** *Incorrect*
- **0.33** *(True Answer)Correct*
- **0.033** *Incorrect*
- **0.0033** *Incorrect*

---

207 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) If the United States imports trades in equal amounts with all four countries, then the effective exchange rate in 2001 is:

- **–1.61%.** *Incorrect*

- **–16.1%.** *Incorrect*
- **–161%.** *(True Answer)Correct*
- **–1611%.** *Incorrect*

---

208 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) If there are no arbitrage possibilities, then the euro-pound exchange rate in 2002 is:

- **1.2.** *(True Answer)Correct*
- **83.** *Incorrect*
- **6.** *Incorrect*
- **5.** *Incorrect*

---

209 **Table: Currency Values III**

Currency	2001	2002
$1	1 euro	.6 euro
$1	3 Brazilian reais	2 Brazilian reais
$1	.75 British pounds	.5 British pounds
$1	40 Indian rupees	30 Indian rupees

Reference: Ref 2-5

(Table: Currency Values III) If there are no arbitrage possibilities, then the pound-real exchange rate in 2001 is:

- **600.** *Incorrect*
- **60.** *Incorrect*
- **0.25.** *(True Answer)Correct*
- **1.2.** *Incorrect*

---

210 **A term that categorizes patterns of exchange rate behavior is known as:**

- **exchange rate regimes.** *(True Answer)Correct*
- **exchange rate realms.** *Incorrect*
- **exchange rate principles.** *Incorrect*

- **exchange rate observations.** *Incorrect*

---

211 **If a government wishes to limit or prohibit fluctuations in exchange rates, it will choose:**

- **to fix, or peg, the value of its currency to some base currency over a sustained period.** *(True Answer)Correct*
- **to allow its currency to rise or fall in price, depending on a variety of supply and demand factors.** *Incorrect*
- **to suspend purchases and sales of its currency.** *Incorrect*
- **to allow the rate to be set by international banks.** *Incorrect*

---

212 **A flexible or floating exchange rate system is one in which the:**

- **government closely monitors and controls the value due to the impact on trade flows.** *Incorrect*
- **government makes no attempt to fix it against any base currency.** *(True Answer)Correct*
- **government actively tries to achieve fluctuations in the rate.** *Incorrect*
- **government fixes the rate against the currency of its largest trading partner.** *Incorrect*

---

213 **When exchange rates are limited to small fluctuations, but not totally fixed, economists refer to the situation as:**

- **essentially fixed.** *Incorrect*
- **essentially floating.** *Incorrect*
- **relatively floating.** *Incorrect*
- **intermediate regimes.** *(True Answer)Correct*

---

214 **Which of the following exchange rate systems is in the right order, from most control to least control?**

- **floating, fixed, managed float** *Incorrect*
- **fixed, floating, managed float** *Incorrect*
- **managed float, floating, fixed** *Incorrect*
- **fixed, managed float, floating** *(True Answer)Correct*

---

215 **When exchange rates are very volatile, with a wide range of variation, the currency is said to be:**

- **in limbo.** *Incorrect*
- **in free float.** *(True Answer)Correct*

- **perfectly flexible.** *Incorrect*
- **in sluggish float.** *Incorrect*

---

216 **What is a currency band?**

- **a limit below which the currency is not allowed to fall** *Incorrect*
- **a limit above which the currency is not allowed to rise** *Incorrect*
- **a fixed rate regime with some small variation allowed, up or down** *(True Answer)Correct*
- **a very rigid control of the currency—no variation allowed** *Incorrect*

---

217 **A middle-ground exchange rate regime, between fixed and floating, is often called:**

- **a managed float.** *Incorrect*
- **a dirty float.** *Incorrect*
- **limited flexibility.** *Incorrect*
- **a managed float, a dirty float, and limited flexibility.** *(True Answer)Correct*

---

218 **A large and sudden currency depreciation is widely known as:**

- **a managed float.** *Incorrect*
- **a crawling peg.** *Incorrect*
- **an exchange rate or currency crisis.** *(True Answer)Correct*
- **a free float.** *Incorrect*

---

219 **A sudden and pronounced loss of value of one nation's currency against others is known as:**

- **a currency crisis.** *(True Answer)Correct*
- **a forced devaluation.** *Incorrect*
- **a thinning of value.** *Incorrect*
- **a default.** *Incorrect*

---

220 **An exchange rate crisis is:**

- **when the currency is stable.** *Incorrect*
- **when the value of a currency declines dramatically.** *(True*

Answer)Correct

- **when the value of a currency increases dramatically.** *Incorrect*
- **when a country fixes the price of its currency.** *Incorrect*

---

221 **A crawling peg refers to:**

- **a large and sudden currency depreciation.** *Incorrect*
- **a fixed exchange rate regime in which the currency is adjusted very frequently to reflect market conditions.** *(True Answer)Correct*
- **a managed or dirty float, depending on the business cycle.** *Incorrect*
- **a drag on exchange rate adjustment caused by imperfect markets.** *Incorrect*

---

222 **Which nation took the bold step of abandoning its own currency and adopting the U.S. dollar?**

- **China** *Incorrect*
- **India** *Incorrect*
- **Mexico** *Incorrect*
- **Ecuador** *(True Answer)Correct*

---

223 **Which European nation has kept its own currency and maintains a fixed value against the euro?**

- **Great Britain** *Incorrect*
- **Belgium** *Incorrect*
- **Denmark** *(True Answer)Correct*
- **Russia** *Incorrect*

---

224 **Since the mid-1990s, the Argentine peso has experienced:**

- **a one-to-one peg with the U.S. dollar.** *Incorrect*
- **a large devaluation and crisis.** *Incorrect*
- **limited flexibility after which it was kept in a narrow band with the dollar.** *Incorrect*
- **All of the answers are correct.** *(True Answer)Correct*

---

225 **A nation that allowed its currency to steadily depreciate (crawl) over a 6-year period is:**

- **France.** *Incorrect*
- **Canada.** *Incorrect*
- **the United Kingdom.** *Incorrect*
- **Colombia.** *(True Answer)Correct*

---

226 **Some nations such as Ecuador chose dollarization because:**

- **the currency was depreciating so rapidly it became nearly worthless.** *(True Answer)Correct*
- **Ecuadorians wanted to save dollars for eventual emigration to the U.S.** *Incorrect*
- **the Ecuadorian currency was backed by gold, which was confiscated by government officials.** *Incorrect*
- **All of the answers are correct.** *Incorrect*

---

227 **The International Monetary Fund has classified 192 economies comparing:**

- **the value of their currencies.** *Incorrect*
- **the percentage of women in the workforce.** *Incorrect*
- **the effectiveness of governance and institutions.** *Incorrect*
- **the flexibility of their exchange rate regimes.** *(True Answer)Correct*

---

228 **Across the globe, exchange rate regimes are:**

- **mostly fixed.** *Incorrect*
- **a mix of fixed and floating.** *(True Answer)Correct*
- **mostly floating.** *Incorrect*
- **hard to pinpoint.** *Incorrect*

---

229 **A currency board is set up:**

- **to manage free-floating currencies.** *Incorrect*
- **to gradually eliminate currency pegs.** *Incorrect*
- **to give a peg added durability.** *(True Answer)Correct*
- **to immediately eliminate currency pegs.** *Incorrect*

---

230 **Some nations use a currency board to manage their currencies. How does this work?**

- **It is all in the hands of international banks.** *Incorrect*

- **The International Monetary Fund manages the currency.** *Incorrect*
- **There is a fixed rate regime with a set of strict rules and policy guidelines to keep the currency's value stable.** *(True Answer)Correct*
- **The currency is allowed to float, but its fluctuations are reviewed periodically by a board of economists.** *Incorrect*

---

231 **Eurozone countries:**

- **have no separate legal tender.** *(True Answer)Correct*
- **all are pegged to the euro.** *Incorrect*
- **all are pegged to the dollar.** *Incorrect*
- **are fixed against a single currency.** *Incorrect*

---

232 **If a nation abandons its own currency and decides to use another nation's currency as its own circulating currency, this is known as:**

- **euro-zoning.** *Incorrect*
- **dollarization.** *(True Answer)Correct*
- **a managed float.** *Incorrect*
- **a Western regime.** *Incorrect*

---

233 **Dollarization refers to:**

- **increased trade with the United States, resulting in a glut of dollars circulating in the domestic economy.** *Incorrect*
- **the fall of the U.S. dollar.** *Incorrect*
- **the dominance of the U.S. dollar in international finance.** *Incorrect*
- **the adoption of the U.S. dollar as an official currency by nations outside the United States, such as El Salvador and Ecuador.** *(True Answer)Correct*

---

234 **The foreign exchange market refers to:**

- **a physical place in the heart of New York City's financial district, where traders come to trade other currencies.** *Incorrect*
- **a collection of all purchases and sales of one currency for another, where exchange rates are determined.** *(True Answer*

)Correct

- **the discount window of the Federal Reserve.** *Incorrect*
- **the commodity futures market.** *Incorrect*

---

235 **From 1992–2007, the volume of currency traded worldwide:**

- **slumped due to the world recession.** *Incorrect*
- **increased approximately 290%.** *(True Answer)Correct*
- **fluctuated wildly due to investor expectations.** *Incorrect*
- **was concentrated in trades in the developing world.** *Incorrect*

---

236 **Which of the following correctly ranks the size of the three largest foreign currency trading centers in dollar volume?**

- **1-Paris; 2-Miami; 3-London** *Incorrect*
- **1-New York; 2-Rome; 3-Chicago** *Incorrect*
- **1-London; 2-New York; 3-Tokyo** *(True Answer)Correct*
- **1-Tokyo; 2-Los Angeles; 3-Paris** *Incorrect*

---

237 **Which of the following is NOT a major foreign exchange center?**

- **London** *Incorrect*
- **New York** *Incorrect*
- **Tokyo** *Incorrect*
- **Chicago** *(True Answer)Correct*

---

238 **Foreign exchange is traded:**

- **weekly on the Internet in special auctions arranged by the Federal Reserve.** *Incorrect*
- **continuously all over the world 24/7.** *(True Answer)Correct*
- **only in officially designated trading centers such as London or New York.** *Incorrect*
- **None of the answers is correct.** *Incorrect*

---

239 **The spot market for foreign exchange is(are):**

- **a market that exists only in one place at one time.** *Incorrect*
- **when a person borrows to speculate in the market.** *Incorrect*
- **purchases and sales of currencies for immediate**

delivery. *(True Answer)Correct*

- **the rate of exchange quoted during the next business day.** *Incorrect*

---

240 **A spot contract is:**

- **a promise to purchase a foreign currency in 30 days.** *Incorrect*
- **a promise to purchase a foreign currency in 90 days.** *Incorrect*
- **a contract for the immediate exchange of currencies.** *(True Answer)Correct*
- **an agreement to sell currencies at a fixed price indefinitely.** *Incorrect*

---

241 **In 2007, the volume of currency traded in the foreign market was:**

- **$3.2 billion.** *Incorrect*
- **$32 billion.** *Incorrect*
- **$321 billion.** *Incorrect*
- **$3210 billion.** *(True Answer)Correct*

---

242 **What percent of currency transactions involve a trade in the spot market?**

- **30%** *Incorrect*
- **40%** *Incorrect*
- **60%** *Incorrect*
- **90%** *(True Answer)Correct*

---

243 **A transaction cost associated with spot trading is:**

- **travel to and from the market.** *Incorrect*
- **shipping costs.** *Incorrect*
- **brokerage commissions.** *Incorrect*
- **the spread, which is earned mostly by large banks.** *(True Answer)Correct*

---

244 **Spreads in quotations of exchange rates are:**

- **the geographical dispersion of nations that use the**

currency. *Incorrect*

- **a measure of contagion involved in changes in exchange rates.** *Incorrect*
- **the difference in the price the buyer pays versus the price the seller receives.** *(True Answer)Correct*
- **the percentage of interest one pays when borrowing to purchase currencies.** *Incorrect*

---

245 **Market spreads usually range from _____ on large contracts to _____ on small contracts.**

- **3%; 0.5%** *Incorrect*
- **10%; 2%** *Incorrect*
- **1%; 2%** *Incorrect*
- **0.01%; 5%** *(True Answer)Correct*

---

246 **The difference between the buy at and sell at price is referred to as:**

- **market friction.** *Incorrect*
- **transaction cost.** *Incorrect*
- **menu cost.** *Incorrect*
- **market friction and transaction cost.** *(True Answer)Correct*

---

247 **A derivative is a:**

- **contract derived from a spot market rate.** *(True Answer)Correct*
- **fixed exchange rate.** *Incorrect*
- **flexible exchange rate.** *Incorrect*
- **contract derived from an exchange rate.** *Incorrect*

---

248 **Forwards, swaps, futures, and options are examples of:**

- **spot market transactions.** *Incorrect*
- **transaction costs.** *Incorrect*
- **market frictions.** *Incorrect*
- **derivatives.** *(True Answer)Correct*

---

249 **The difference between the spot contract and a forward contract is that:**

- **the former is a flexible price on the currency, and the latter is**

a fixed price. *Incorrect*

- **the former is a contract to be settled immediately, and the latter is a contract to be settled at a future agreed-upon date.** *(True Answer)Correct*
- **the former is a derivative, and the latter is not a derivative.** *Incorrect*
- **the former has a fixed price but the contract can be settled at a later date, and the latter is a contract to be settled immediately.** *Incorrect*

---

250 **In which of the following categories would an agreement to trade currencies in pre-set amounts at a certain date in the future be included?**

- **an option** *Incorrect*
- **a futures contract** *(True Answer)Correct*
- **a forward contract** *Incorrect*
- **a swap** *Incorrect*

---

251 **The forward contract differs from a futures contract in that:**

- **the forward contract is to be settled immediately.** *Incorrect*
- **the futures contract is for a fixed amount and matures at certain arranged dates, whereas the forward contract can be for any amount.** *(True Answer)Correct*
- **the futures contract cannot be traded in a market, whereas the forward contract can be bought in the market.** *Incorrect*
- **forward contracts are standardized, whereas futures contracts are not standardized.** *Incorrect*

---

252 **Foreign exchange contracts, such as futures, swaps, and options are collectively known as:**

- **derivatives.** *(True Answer)Correct*
- **deposits.** *Incorrect*
- **spot contracts.** *Incorrect*
- **spreads.** *Incorrect*

---

253 **The forward market is:**

- **a market that exists only in one place at one time.** *Incorrect*
- **when a person borrows to speculate in the market.** *Incorrect*
- **purchases and sales of currencies for delivery at a later**

time—up to 1 year. *(True Answer)Correct*

- **the rate of exchange quoted during the next business day.** *Incorrect*

---

254 **In which of the following categories would an agreement to buy or sell a certain quantity of a specified currency at a fixed price at a date 30, 60, 90, 120, or 360 days in the future be included?**

- **an option** *Incorrect*
- **a futures contract** *Incorrect*
- **a forward contract** *(True Answer)Correct*
- **a swap** *Incorrect*

---

255 **Foreign exchange swaps involve:**

- **selling one currency on the spot market and at the same time purchasing it forward.** *(True Answer)Correct*
- **trading goods rather than money to improve efficiency.** *Incorrect*
- **delaying payment of a spot contract until the currency is actually delivered.** *Incorrect*
- **a promissory note with repayment in 60 days.** *Incorrect*

---

256 **In which of the following categories would the sale of foreign currency with a forward repurchase agreement be included?**

- **an option** *Incorrect*
- **a futures contract** *Incorrect*
- **a forward contract** *Incorrect*
- **a swap** *(True Answer)Correct*

---

257 **A foreign exchange option is:**

- **the right to engage in buying or selling on the spot market.** *Incorrect*
- **the right to purchase (call) or sell (put) foreign currency at a specified price on a specified date in the future.** *(True Answer)Correct*
- **when the price of foreign currency exceeds the spot rate.** *Incorrect*
- **when a speculator must decide whether to move into the market.** *Incorrect*

---

258 **An agreement that gives one party the right to buy or sell from or to another party a specified quantity of currency at a specified price would be included in which of the following transactions?**

- **an option** *(True Answer)Correct*
- **a futures contract** *Incorrect*
- **a forward contract** *Incorrect*
- **a swap** *Incorrect*

---

259 **In international finance, hedging indicates:**

- **not being able to make a commitment to buy or sell.** *Incorrect*
- **delaying a purchase of foreign exchange hoping the price will fall.** *Incorrect*
- **simultaneously buying several currencies to ensure that at least one will rise in value.** *Incorrect*
- **avoiding risk of loss by offsetting an obligation to buy a foreign currency by locking in a contract to sell it at the same time.** *(True Answer)Correct*

---

260 **When exchange rates are _____, agreeing to an international transaction 1 week from today carries _____.**

- **flexible rather than fixed; less risk** *Incorrect*
- **flexible rather than fixed; the same amount of risk** *Incorrect*
- **flexible rather than fixed; more risk** *(True Answer)Correct*
- **fixed rather than flexible; the same amount of risk** *Incorrect*

---

261 **In international finance, speculation involves:**

- **not being able to make a commitment to buy or sell.** *Incorrect*
- **taking a risk by purchasing (or selling) a foreign currency asset, holding it in anticipation of a rate increase (decrease).** *(True Answer)Correct*
- **simultaneously buying several currencies to ensure that at least one will rise in value.** *Incorrect*
- **avoiding risk of loss by offsetting an obligation to buy a foreign currency by locking in a contract to sell it at the same time.** *Incorrect*

---

262 **Interbank trading is:**

- **a monopoly business in the United States.** *Incorrect*
- **controlled by just 10 banks.** *(True Answer)Correct*
- **a state-mandated business.** *Incorrect*
- **a highly competitive market, with hundreds of banks offering services.** *Incorrect*

---

263 **Why does a government impose controls or restrictions on converting domestic currency to foreign currency (capital controls)?**

- **The government is trying to stop the rapid decline in value of the domestic currency.** *Incorrect*
- **The government wants to stave off an "attack" by a currency speculator.** *Incorrect*
- **If the government is trying to maintain a fixed rate, it cannot allow free trade of the currency.** *Incorrect*
- **Any of the above answers could be reasons.** *(True Answer)Correct*

---

264 **When a government sets limits or puts any restrictions on the international flow of currency or payments, those measures are called:**

- **forex regulation and restriction.** *Incorrect*
- **capital controls.** *(True Answer)Correct*
- **safeguard measures.** *Incorrect*
- **black-market measures.** *Incorrect*

---

265 **Why may a "black market" develop in nations in which government has imposed capital controls?**

- **All foreign currency purchases and sales are conducted and controlled by the government, and it is illegal to trade privately.** *(True Answer)Correct*
- **Traders are trying to avoid the taxes they must pay on each transaction.** *Incorrect*
- **The government makes a huge profit on currency trades that the private sector wants access to.** *Incorrect*
- **None of the answers is correct.** *Incorrect*

---

266 **To bypass capital controls, people who need foreign currency sometimes resort to:**

- **forward foreign exchange markets.** *Incorrect*
- **stock markets.** *Incorrect*
- **black markets.** *(True Answer)Correct*
- **farmers markets.** *Incorrect*

---

267 **Foreign exchange market intervention refers to:**

- **actions taken by speculators to increase profits from trading.** *Incorrect*
- **actions taken to lower currency trading risks and make the markets safer.** *Incorrect*
- **the forgiving of penalties and other punishments for illegal foreign exchange activities.** *Incorrect*
- **government purchases or sales of a nation's own currency in international markets to change or stabilize the value of the currency.** *(True Answer)Correct*

---

268 **To avoid the imposition of capital controls, a government wishing to keep its exchange rate at a certain level may rely on:**

- **forbidding all sales or purchases of foreign currency.** *Incorrect*
- **asking the large banks to keep the prices at a certain level.** *Incorrect*
- **asking for loans from the International Monetary Fund (IMF).** *Incorrect*
- **intervention in the foreign exchange market to raise or lower the exchange rate.** *(True Answer)Correct*

---

269 **To maintain a fixed exchange rate via intervention in the markets, a government should:**

- **be ready to crack down on illegal traders.** *Incorrect*
- **be ready to buy the home currency with foreign currency reserves when the home currency's value declines.** *(True Answer)Correct*
- **be ready to sell the home currency when the home currency's value declines.** *Incorrect*
- **be ready to borrow funds from international banks when the home currency's value declines.** *Incorrect*

---

270 **Foreign exchange arbitrage refers to:**

- **the simultaneous purchase and sale of a foreign currency asset in different markets to take advantage of a price differential.** *(True Answer)Correct*
- **actions taken to lower currency trading risks and make the markets safer.** *Incorrect*
- **the forgiving of penalties and other punishments for illegal foreign exchange activities.** *Incorrect*
- **government purchases or sales of a nation's own currency in international markets to change or stabilize the value of the currency.** *Incorrect*

---

271 **Capital control is described by all of the following *except*:**

- **restricting merchandise trade.** *(True Answer)Correct*
- **restricting the trade in foreign exchange.** *Incorrect*
- **channeling the currency trade through the government.** *Incorrect*
- **restricting cross-border financial transactions.** *Incorrect*

---

272 ***Parallel markets* is another term for:**

- **government interventions.** *Incorrect*
- **interbank trades.** *Incorrect*
- **black markets.** *(True Answer)Correct*
- **trade in goods and in services.** *Incorrect*

---

273 **Arbitrage is:**

- **capital controls.** *Incorrect*
- **interest rate management by the central bank.** *Incorrect*
- **exploiting profit opportunities in the market resulting from price differences.** *(True Answer)Correct*
- **investing in junk bonds or businesses that are not ethical.** *Incorrect*

---

274 **Whenever there is a difference in the same exchange rate offered in two markets, an arbitrageur would:**

- **wait for the markets to come to equilibrium.** *Incorrect*
- **buy in the market where the currency is offered at the cheaper rate, and simultaneously sell the currency where the rates are higher.** *(True Answer)Correct*

- **sell the cheaper-rate currency in the home market.** *Incorrect*
- **not consider the trade since prices would undoubtedly change before it could be executed.** *Incorrect*

---

275 **Suppose $1 = 10.5 pesos in New York and $1 = 9.6 pesos in Mexico City. If you had $10,000 using arbitrage, your profits would be:**

- **$937.50.** *(True Answer)Correct*
- **937 pesos.** *Incorrect*
- **9600 pesos.** *Incorrect*
- **$790.** *Incorrect*

---

276 **If the U.S. interest rate is 4% per year and the U.K. interest rate is 9% per year, then:**

- **an investor will see no reason to invest in the United Kingdom.** *Incorrect*
- **an investor will borrow money in the United Kingdom and invest it in the United States.** *Incorrect*
- **an investor can borrow money in the United States and invest in the United Kingdom and profit.** *(True Answer)Correct*
- **an investor will find that the returns are the same in both countries.** *Incorrect*

---

277 **Arbitrage with two currencies is not possible when:**

- **there is an exchange rate difference in two markets.** *Incorrect*
- **traders are familiar with markets.** *Incorrect*
- **the exchange rates are in equilibrium: the same is occurring in all markets.** *(True Answer)Correct*
- **the exchange rates are extremely volatile.** *Incorrect*

---

278 **Suppose $1 = 1.5 euros in London and $1 = 1.2 euros in New York. Which of the following would be the right trade for you to make money?**

- **You sell 1000 euros in London and buy euros in New York.** *Incorrect*
- **You sell dollars in New York and buy dollars in London.** *Incorrect*
- **You sell dollars in London and buy dollars in New York.** *(True Answer)Correct*
- **You sell euros in London and buy dollars in New**

York. *Incorrect*

---

279 **Suppose $1 = 120 yen in New York, $1 = 2 euros in London, and 1 euro = 75 yen in Tokyo. A speculator with $1 million would get a profit of _____ by engaging in a 3-point arbitrage.**

- **$1.20** *Incorrect*
- **150,000 yen** *Incorrect*
- **$250,000** *(True Answer)Correct*
- **$1.25 million** *Incorrect*

---

280 **When it is possible to trade two separate currencies for a common third currency, economists refer to profit opportunities as:**

- **backward arbitrage.** *Incorrect*
- **speculation.** *Incorrect*
- **triangular arbitrage.** *(True Answer)Correct*
- **forced equilibrium.** *Incorrect*

---

281 **Approximately how many different national currencies exist in the world today?**

- **more than 150** *(True Answer)Correct*
- **more than 5,000** *Incorrect*
- **12** *Incorrect*
- **535** *Incorrect*

---

282 **If 1 euro is priced at $1.25 and if 1 euro will also buy 88 Japanese yen (€1 = ¥88), in equilibrium, with no arbitrage opportunities, how much is the cross rate between the yen and the dollar (yen-dollar rate)?**

- **¥150/$** *Incorrect*
- **¥70.4/$** *(True Answer)Correct*
- **¥20/$** *Incorrect*
- **¥5/$** *Incorrect*

---

283 **A vehicle currency is:**

- **contraband—it is used to smuggle other assets into controlled economies.** *Incorrect*
- **a widely accepted, tradable currency that serves as a currency to use for buying or selling one's own.** *(True Answer)Correct*
- **a currency whose value changes rapidly and**

erratically. *Incorrect*

- **a currency used to purchase imports of autos, buses, and other transportation equipment.** *Incorrect*

---

284 **Suppose the average interest rate on euro bonds is 4%, and the average interest rate on U.S. dollar bonds is 6%. Which should the investor choose?**

- **neither—bonds have high default rates.** *Incorrect*
- **both—an investor will choose some euro bonds and some U.S. bonds to diversify.** *Incorrect*
- **the euro bond because their economies are usually more stable.** *Incorrect*
- **It is not possible to answer without information on exchange rates.** *(True Answer)Correct*

---

285 **The forward exchange rate:**

- **allows investors to be sure of the price at which they can trade forex in the future.** *(True Answer)Correct*
- **is the rate at which a trader can purchase currency for immediate delivery.** *Incorrect*
- **is the rate of discount that international banks get when they purchase.** *Incorrect*
- **is the rate that speculators consider if they are looking for bargain prices.** *Incorrect*

---

286 **If investors can cover themselves in the forward market, they will take advantage of interest rate differentials by:**

- **buying assets (lending) denominated in the high-interest rate currency, and selling assets (borrowing) in the low-interest rate currency.** *(True Answer)Correct*
- **removing funds from both investments.** *Incorrect*
- **turning over their investment portfolio to an expert in one of the two nations.** *Incorrect*
- **selling assets denominated in high-interest rate currency and buying assets in the low-interest rate currency.** *Incorrect*

---

287 **There can be an opportunity for covered interest arbitrage if:**

- **the interest rate is low and the exchange rate is high.** *Incorrect*

- **the forward/spot rate difference is either larger or smaller in percentage terms than the difference in the interest rates on two currencies.** *(True Answer)Correct*
- **there is a time lag on the settlement of the transactions.** *Incorrect*
- **the interest rate is high and the exchange rate is low.** *Incorrect*

---

288 **Covered interest parity refers to the situation in which:**

- **interest rates are the same in both currencies.** *Incorrect*
- **spot and forward rates are the same in both currencies.** *Incorrect*
- **the forward rate between the two currencies is equal to the ratio of their returns times the spot rate between the two currencies.** *(True Answer)Correct*
- **there is an opportunity for arbitrage whenever prices are sluggish and sticky.** *Incorrect*

---

289 **If the future rate equals the spot rate, then in equilibrium:**

- **the exchange rate must depreciate.** *Incorrect*
- **interest rates should be different.** *Incorrect*
- **the exchange rate will appreciate.** *Incorrect*
- **None of the answer choices is correct.** *(True Answer)Correct*

---

290 **Whenever nations impose capital controls on their currencies:**

- **returns are equalized and arbitrage opportunities disappear.** *Incorrect*
- **there is no opportunity for trade or arbitrage, and differences in returns persist.** *(True Answer)Correct*
- **the government sets the returns on its currency, so traders cannot make profits.** *Incorrect*
- **in those nations, because government has ensured its safety, capital is free to move.** *Incorrect*

---

291 **Risky interest arbitrage refers to:**

- **borrowing in the low-interest currency and lending in the high-interest currency without covering against a change in the**

exchange rates. *(True Answer)Correct*

- **foolish actions that usually are not successful.** *Incorrect*
- **activities that are designed to raise or lower interest rates but are risky.** *Incorrect*
- **the practice of depositing all of one's funds in one currency without regarding the pros and cons of such a transaction.** *Incorrect*

---

292 **Liquidity of an asset refers to:**

- **its level of risk.** *Incorrect*
- **whether it is held domestically or overseas.** *Incorrect*
- **the ease with which it can be sold.** *(True Answer)Correct*
- **its volatility.** *Incorrect*

---

293 **The situation in which the difference in interest rates between two currencies is equal to the expected change in the spot rate over the same time period is known as:**

- **covered interest arbitrage.** *Incorrect*
- **covered interest parity.** *Incorrect*
- **uncovered interest parity.** *(True Answer)Correct*
- **the forward-spot reversal.** *Incorrect*

---

294 **As the expected future spot rate moves closer to the spot rate, uncovered interest parity indicates that:**

- **interest rates should remain constant.** *Incorrect*
- **interest rates should converge.** *(True Answer)Correct*
- **interest rates should diverge.** *Incorrect*
- **The answer depends on whether the expected future spot rate is higher or lower than the spot rate.** *Incorrect*

---

295 **In equilibrium, the expected future spot rate is equal to:**

- **the current spot rate.** *Incorrect*
- **the current interest rate.** *Incorrect*
- **the interest rate spread.** *Incorrect*
- **the current forward rate.** *(True Answer)Correct*

---

296 **If the U.S. interest rate is 4% per year and the U.K. interest rate is 9% per year, which of the following statements is true?**

- **The dollar will depreciate 4% in 1 year.** *Incorrect*
- **The pound will depreciate 9% in 1 year.** *Incorrect*
- **The pound will depreciate 5% in 1 year.** *(True Answer)Correct*
- **The dollar will appreciate 4% in 1 year.** *Incorrect*

---

297 **In equilibrium, if both uncovered and covered interest parity hold, what condition should exist?**

- **World interest rates will be equal.** *Incorrect*
- **Rates of inflation will equalize.** *Incorrect*
- **The forward rate will equal the expected future spot rate.** *(True Answer)Correct*
- **The forward rate will decrease as the spot rate rises.** *Incorrect*

---

298 **Whenever a nation's currency is expected to depreciate because of various market conditions, the following situation exists with respect to its forward rate for another currency:**

- **there is a forward discount from the spot rate by the rate of depreciation.** *Incorrect*
- **there is a forward premium from the spot rate by the rate of depreciation.** *(True Answer)Correct*
- **there is no difference between the spot and forward rates.** *Incorrect*
- **there is no predictable relationship between the spot and forward rates.** *Incorrect*

---

299 **The expected rate of currency depreciation is equal to the proportional difference between the forward rate and the spot rate. This is known as:**

- **the forward depreciation.** *Incorrect*
- **the backward depreciation.** *Incorrect*
- **the forward premium.** *(True Answer)Correct*
- **the backward premium.** *Incorrect*

---

300 **The total rate of return on an international asset is:**

- **the spot rate plus the forward rate.** *Incorrect*
- **the rate of return on the asset plus or minus the expected capital gain or loss on currency changes.** *(True Answer)Correct*

- **the rate of return on the asset minus commissions.** *Incorrect*
- **the rate of return plus inflation minus taxes.** *Incorrect*

---

301 **In equilibrium, the interest parity condition requires that:**

- **all rates of returns will equalize.** *Incorrect*
- **all spot and forward rates will equalize.** *Incorrect*
- **the home interest rate minus its expected rate of currency depreciation (against the foreign country) will equal the foreign interest rate on similar assets.** *(True Answer)Correct*
- **all rates of returns and forward rates will equalize.** *Incorrect*

---

302 **From uncovered interest parity, we know that when the domestic currency is expected to depreciate, the domestic interest rate should be:**

- **greater than the foreign interest rate.** *(True Answer)Correct*
- **greater than the foreign exchange rate.** *Incorrect*
- **less than the foreign interest rate.** *Incorrect*
- **less than the foreign exchange rate.** *Incorrect*

---

303 **From uncovered interest parity, we know that when the domestic interest rate is greater than the foreign one:**

- **the domestic currency is expected to appreciate.** *Incorrect*
- **the domestic currency is expected to depreciate.** *(True Answer)Correct*
- **the foreign currency is expected to appreciate.** *Incorrect*
- **the foreign currency is expected to depreciate.** *Incorrect*

---

304 **An appreciation of the dollar is the same as a fall in the euro-dollar exchange rate.**

- **True**
- **False** *(True Answer)*

---

305 **An appreciation of the dollar is the same as a fall in the dollar-euro exchange rate.**

- **True** *(True Answer)*
- **False**

---

306 **A bilateral exchange rate refers to the rate between two nations' currencies.**

- **True** *(True Answer)*
- **False**

---

307 **Since the introduction of the euro, the dollar has appreciated relative to the euro.**

- **True**
- **False** *(True Answer)*

---

308 **A pegged exchange rate system is characterized by frequent changes in the currency price by market forces.**

- **True**
- **False** *(True Answer)*

---

309 **Exchange rates in the developing countries can be much more volatile than those in developed countries.**

- **True** *(True Answer)*
- **False**

---

310 **Almost 90% of foreign currency purchases and sales occur in the spot market.**

- **True** *(True Answer)*
- **False**

---

311 **Most foreign currency sales and purchases in the spot market are conducted by government officials.**

- **True**
- **False** *(True Answer)*

---

312 **A spread in foreign exchange markets refers to a buying price greater than the selling price of a currency.**

- **True**
- **False** *(True Answer)*

---

313 **A futures contract requires that the same individual who bought the contract must settle the contract.**

- **True**
- **False** *(True Answer)*

---

314 **An option provides the buyer the right to purchase or sell currencies, without the obligation to trade.**

- **True** *(True Answer)*
- **False**

---

315 **Hedging is the opposite of speculation.**

- **True** *(True Answer)*
- **False**

---

316 **Most foreign exchange trading and speculation is done in the interbank trading market, where large banks trade and transfer deposits.**

- **True** *(True Answer)*
- **False**

---

317 **Interbank trades among 10 international banks are generally the basis for currency rates in the foreign exchange market.**

- **True** *(True Answer)*
- **False**

---

318 **An investor can eliminate risk on fixed-interest foreign assets by “covering” herself in the forward market.**

- **True** *(True Answer)*
- **False**

---

319 **Compared to current times, during the 1960s and 1970s, profits from arbitrage were very large, and interest parity was upheld.**

- **True**
- **False** *(True Answer)*

---

320 **If uncovered interest parity holds, the current euro spot rate can be calculated if we know the expected future exchange rate, the dollar interest rate, and the euro interest rate.**

- **True** *(True Answer)*
- **False**

---

321 **Forecasting future exchange rates is one of the most certain aspects of international financial analysis.**

- **True**
- **False** *(True Answer)*

---

322 **If uncovered interest parity holds, the difference in two nations' interest rates is just equal to the expected rate of depreciation**

of the higher rate currency versus the lower rate currency.

- **True** *(True Answer)*
- **False**

---

323 **Covered interest parity refers to the equilibrium condition in which all interest rates are equal when the spot and forward rates are equal to each other.**

- **True**
- **False** *(True Answer)*

---

324 **There is no evidence that covered interest parity holds.**

- **True**
- **False** *(True Answer)*

---

325 **Interest arbitrage can exist when two currencies have different deposit rates on liquid cash balances.**

- **True** *(True Answer)*
- **False**

---

326 **You have studied how nations have adopted a wide variety of exchange rate regimes, from freely floating with almost no intervention, to rigid and fixed with complete control by the government. Other nations have chosen different paths, relinquishing some or all control over their currencies. Discuss two such systems and comment on their differences.**

- **Some nations have chosen to merge their currencies and use a common currency for all nations in a currency union. Europe is the prime example of a currency union, whereby each nation uses the euro rather than each having its own currency with a variety of exchange rates. Monetary policy in the European Currency Union is managed by a central bank with input from all members of the union. Dollarization is a situation in which a nation adopts a strong currency, such as the U.S. dollar, and uses it as its own currency. It cannot print dollars, but it allows all domestic transactions to take place using the dollar. Dollars are acquired by exporting. The nation then does not have to worry about managing its own currency or interest rates.**

---

327 **Assume your company has a contract to purchase 100,000 computers from a Korean company. The payment is due on receipt of the shipment and must be delivered in Korea on December 31, 2010. In July 2010, when you are arranging**

the contract, the computers are priced at 500,000 won each. The spot rate in July 2010 is $1 exchanging for 1250 won.

A) Calculate the U.S. dollar price (in July 2010) of 1 unit of Korean currency.

B) What is the total price of the computers in dollars?

C) What is the total price of the computers in won?

D) What would you advise your firm to do to avoid a loss on the deal if the Korean wo costs 10% more compared to the U.S. dollar when payment is due in December?

•

A) $0.0008

B) 100,000 × (500,000 ÷ 1250) = $4 million

C) 100,000 × 500,000 = won 50 billion

D) The advice should be to "hedge" against the loss of value of the dollar. The firm could buy the won today at the current spot rate and invest it, or buy a forward contract for 120 days to purchase 50 billion won at the prespecified forward rate.

---

328  **In July 2010, the spot rate is $1 exchanging for 1250 won. You are convinced that the won will appreciate by the end of the year. How might you profit if your hunch is correct?**

•

At this time, you can speculate in the forward market: negotiate a forward contract to buy Korean won at a predetermined price. Then, on December 31, execute the contract (buy the won) and sell it in the spot market for a profit.

---

329  **Explain how a trader can exploit an arbitrage opportunity using the spot market and the forward market, after discovering a difference in interest rate returns on two currencies.**

•

Essentially, the trader would borrow funds in the low-interest currency and deposit those funds in the high-interest currency. For instance, if deposit rates were 4% in the United States and 8% in the United Kingdom, a trader should borrow dollars, purchase pounds, invest the pounds in an 8% U.K. deposit for 1 year, retrieve the funds, and reconvert to dollars. To avoid exchange rate risk (the risk that the pound would depreciate against the dollar), the trader would cover his or her transaction in the forward market in the following way: at the same time he or she purchased the pounds with the borrowed dollars, he or she would also negotiate a 1-year forward contract to sell those pounds for dollars. As long as the interest earned is greater than the difference between the spot and

forward rates, the trader is guaranteed to earn money.

---

330 **Suppose the U.S. dollar interest rate is 5% and the euro interest rate is 6%. Assume no transaction costs, fees, or commissions. In all markets, the spot rate for euros is $1.25. You believe in one year's time the spot rate for euros will be $1.30. An investor would like to invest $100,000 for one year and is willing to take on risk for a higher return.**

A) How would you advise her?

B) What if you are incorrect and the euro rate is lower? Calculate the "break-even" exchange rate; that is, an investment that returns the same as investing $100,000 at 5%.

•

A) The best advice would be to invest in euros by purchasing €80,000 for the $100,00 and purchasing a euro asset returning 6%. At the end of 1 year, the investor should sell the asset for €84,800 and then buy dollars on the spot market. If you are correc and the rate is $1.30, the investment will return $10,240, which is a return of over 10%.

B) To calculate the break-even exchange rate, divide the value after one year from the U.S. investment ($105,000) by the value of the euro investment after one year (€84,800) giving a "break-even" exchange rate of $1.24. If the exchange rate goes below $1.24, the U.S. investment would have earned more.