Tutorial: Exchange rate and the foreign exchange market

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Problem 1: Multiple choice questions

1. If the spot rate is greater than the forward rate, this means that
   a. the currency is expected to depreciate in the future
   b. the currency is expected to appreciate in the future
   c. the sport rate is overvalued
   d. the forward rate is undervalued
2. The Canadian dollar trades at US$0.6715 in the spot market and US$0.6713 in the 30-day forward market. The Canadian dollar is trading at
   a. a forward premium
   b. a forward discount
   c. a future premium
   d. a future discount
3. If the rupee is trading at a forward premium against the dollar, interest parity suggests that
   a. interest rate on Indian assets must exceed interest rate on dollar assets
   b. interest rate on US assets must exceed interest rates on Indian assets
   c. interest rates on both assets should be equal
   d. none of the above
4. When a forward rate of INR is less than the spot rate it implies
   a. INR is expected to depreciate
   b. INR is expected to appreciate
   c. INR is expected to stay constant
   d. none of the above

Problem 2

The following table gives the exchange rate of the INR per unit of the foreign currency

Date	USD	Euro
3-Mar-03	47.655	51.3888
4-Mar-03	47.65	52.07
12-Mar-03	47.655	52.515
17-Mar-03	47.66	51.6125
31-Mar-03	47.505	51.4925

- What is the value of USD per INR as of 12 March 2003?
- Between 17 Mar 2003 and 31 Mar 2003, has the dollar depreciated or appreciated against the INR?
- Calculate the Euro per USD rate from the above data as of 4 March 2004 and 31 Mar 2004. Has the Euro appreciated or depreciated against the USD?

Problem 3

What are the reasons for an excess demand for a currency on the spot market?

Problem 4

Explain how each of the following will affect the exchange rate for the INR

- An increase in the foreign demand for Indian textiles
- A decrease in foreign interest rates
- An increase in the Indian interest rates
- A decrease in the GDP of India's trading partners

Problem 5

If R_{USD} is 0.09, R_{INR}= 0.04 and $E_{USD/INR}$=1.05, calculate the forward USD/INR exchange rate given covered interest parity.