2.07 Capital Flows and the FX Market

Question 1
All else being equal, if the domestic price level decreases relative to the foreign price level, the real exchange rate between the two currencies, when quoted as domestic currency per unit of foreign currency, will *most likely*:
A. decrease.
B. remain the same.
C. increase.

Question 2
The exchange rate between the euro (EUR) and the Japanese yen (JPY) is quoted by the amount of JPY per EUR 1 (JPY/EUR). If JPY appreciates against EUR, the spot exchange rate quote will be for a(n):
A. smaller amount of JPY.
B. equal amount of JPY.
C. greater amount of JPY.

Question 3
An investor wants to diversify into foreign currency-denominated securities while minimizing exchange rate risk. Which of the following currency regimes would expose the investor to the *least* exchange rate risk?
A. Target zone
B. Managed float
C. Currency board

Question 4
A country with a well-respected monetary authority maintains the domestic currency exchange rate within 1% of the US dollar through direct and indirect intervention in the currency markets. The country is *most likely* using which of the following currency regimes?
A. Fixed parity
B. Dollarization
C. Currency board

Question 5
A Canadian tourist in Hong Kong needs to exchange Canadian dollars (CAD) for Hong Kong dollars (HKD). A dealer provides a quote of 0.1799 CAD/HKD. Since the inverse of 0.1799 is 5.5586, from the perspective of the Canadian tourist, the dealer's quote is *most appropriately* described as a(n):
A. direct quote of 0.1799 CAD per HKD.
B. direct quote of 5.5586 HKD per CAD.
C. indirect quote of 0.1799 CAD per HKD.

Question 6
For this question, assume that GBP is the domestic currency and INR is the foreign currency. If the consumer price index (CPI) in the United Kingdom rises more than the CPI in India, the real INR/GBP exchange rate *most likely*:
A. will decrease, and the purchasing power of the INR will increase.
B. will increase, and the purchasing power of the INR will decrease.
C. will decrease, and the purchasing power of the INR will decrease.

Question 7
When a country uses dollarization as a currency regime, which of the following is the *most likely* consequence?
A. It loses the ability to set its own monetary policy.
B. It maintains foreign currency reserves against its monetary base.
C. Domestic bank interest rates are close to those of the adopted country.

Question 8
A Singapore-based investor holds assets in New Zealand denominated in NZD. The investor forecasts the following changes over the next year:

SGD/NZD spot exchange rate	+6%
SGD nominal inflation rate	+3%
NZD nominal inflation rate	−2%

Based on this information, the expected change in the SGD/NZD real exchange rate is *closest* to:
A. 1%
B. 5%
C. 11%

Question 9
According to the Marshall-Lerner condition, domestic currency devaluation is *least likely* to improve a country's trade balance if the mix of imports and exports primarily consists of:
A. luxury goods.
B. goods with few available substitutes.
C. goods that represent a large portion of a consumer's budget.

Question 10
If the Japanese yen/US dollar (JPY/USD) spot rate declines 5% from 120 to 114, the appreciation of JPY relative to USD is *most likely*:
A. less than 5%.
B. equal to 5%.
C. greater than 5%.

Question 11
A country has deficits in both its current account and financial account. Its currency appreciates significantly, causing the current account deficit to increase. Assuming no change in the financial account, which of the following must occur to keep the balance of payments in balance?
A. A capital account deficit decrease
B. A capital account surplus increase
C. A capital account surplus decrease

Question 12
Conventionally, which of the following is *most likely* part of the sell side of the foreign currency market?
A. A large international bank that makes a market in all major currencies
B. A multinational manufacturer generating revenues in multiple currencies
C. A central bank that intervenes in currency markets to maintain a fixed exchange rate

Question 13
An analyst gathers the following information:

Spot CAD/AUD	0.9434
AUD Consumer Price Index	119.7
Expected Australian inflation rate	2.0%
CAD Consumer Price Index	144.4
Expected Canadian inflation rate	3.50%

The real CAD/AUD exchange rate is *closest* to:
A. 0.7820
B. 0.9575
C. 1.1380

Question 14
A lender is *most likely* to benefit when, over the life of a loan, actual inflation:
A. is less than expected inflation.
B. equals expected inflation.
C. is greater than expected inflation.

Question 15
After a 6% depreciation of the euro (EUR) versus the Japanese yen (JPY), the exchange rate between the currencies is JPY/EUR 120. Before EUR depreciation, the JPY/EUR exchange rate was *closest* to:
A. 113.21
B. 127.20
C. 127.66

Question 16
If the Canadian dollar (CAD) depreciates 3% against the Australian dollar (AUD) over a period, then the appreciation of the AUD against the CAD is *most likely*:
A. less than 3%.
B. equal to 3%.
C. greater than 3%.

Question 17
If the Swiss franc (CHF) appreciated by 4% against the euro (EUR), the percentage decline of EUR is *closest* to:
A. 3.85%
B. 4.00%
C. 4.17%

Question 18
An analyst gathers the following information:

	Spot rates	**Expected spot rates in six months**
USD/CAD	0.8650	0.8740
JPY/USD	98.50	97.50
USD/EUR	1.2050	1.1950

Based on this information, which currency is *most likely* to show the greatest percentage appreciation versus USD?
A. CAD
B. JPY
C. EUR

Question 19
If a Brazilian converts BRL 781.25 to EUR 125, then the direct exchange rate from the Brazilian's perspective is *closest* to:
A. 0.16 BRL/EUR
B. 6.25 EUR/BRL
C. 6.25 BRL/EUR

Question 20
A US investor receives a dividend payment from a French company. The dividend is *most appropriately* classified as a:
A. US current account debit.
B. US financial account credit.
C. French capital account debit.

Question 21

A government would *most likely* impose capital restrictions in order to:

A. reduce imports that compete with domestic producers.

B. limit foreign influence in strategically important sectors.

C. restrict flight of foreign capital during economic expansions.