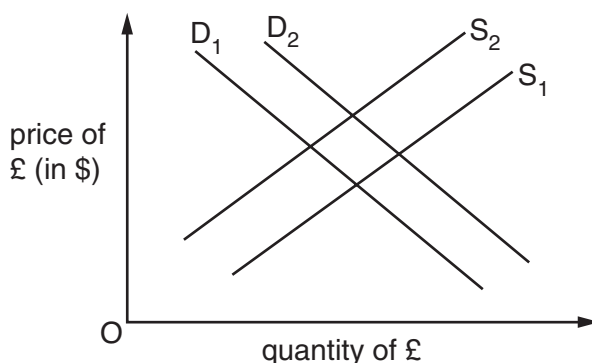


- 26 In the diagram  $D_1$  and  $S_1$  are the initial supply and demand curves of the pound sterling (£) on the foreign exchange markets.



What will cause the demand curve to shift to  $D_2$  and the supply curve to  $S_2$ ?

- A a depreciation of the pound sterling
  - B a decrease in UK interest rates
  - C an increase in the price levels of other countries
  - D an increase in the level of UK import tariffs
- 27 Which of the following combinations indicates that a country has a freely floating exchange rate?

|   | nominal<br>exchange rate | foreign<br>currency reserves |
|---|--------------------------|------------------------------|
| A | depreciates by 20%       | decrease by \$1 billion      |
| B | depreciates by 20%       | unchanged                    |
| C | unchanged                | decrease by \$1 billion      |
| D | unchanged                | unchanged                    |

- 28 In the United States a representative basket of goods costs \$4000.

At the current actual exchange rate between the US\$ and the £ sterling the same basket of goods in the UK would cost \$5000.

What can be deduced from this?

- A The £ sterling is 25% over-valued against the US\$.
- B The £ sterling is 20% under-valued against the US\$.
- C The purchasing power parity exchange rate of the £ sterling is \$1.25 to the £.
- D The purchasing power parity exchange rate of the £ sterling is \$0.80 to the £.