COLEGIO MAYOR DE NUESTRA SEÑORA DEL ROSARIO

Part I: Multiple Selection Questions

For question 1 and 2 use the following table:

CURRENCY	VALUE	% CHANGE	DATE/TIME
EUR-USD	1.3501	0.2657%	09/23
GBP-USD	1.5449	0.6912%	09/23
USD-JPY	76.6083	0.4784%	09/23
AUD-USD	0.9779	0.3813%	09/23
USD-CAD	1.0281	-0.0301%	09/23
USD-CHF	0.9057	-0.3395%	09/23

Source: Bloomber, September 23/2011

1. On September 23/2011, the USD:
    a. Appreciated against the Euro, the GBP and AUD.
    b. Depreciated against the Euro, the GBP and the Japanese Yen.
    c. Depreciated against the Euro, the GBP and AUD.
    d. Depreciated against the Euro, the GBP and AUD.

2. On September 23/2011, the Swiss franc and the United Kingdom Pound:
    a. Appreciated against the USD.
    b. Depreciated against the USD.
    c. Presented an arbitrage opportunity.
    d. All of the above.

For question 3 and 4 you must use the following information:

Suppose that the current spot exchange rate is €1.50/£ and the one-year forward exchange rate is €1.60/£. The one-year interest rate is 5.4% in euros and 5.2% in pounds. You can borrow at most €1,000,000 or the equivalent pound amount, i.e., £666,667, at the current spot exchange rate.

3. The size of the arbitrage profit is:
    a. €68,134.
    b. €68,130.
    c. €68,126.
    d. 5.2%.
    e. There is no arbitrage opportunity.

4. The interest rate parity may be restored as a result of
    a. Arbitrage transactions. The euro interest rate will rise; the pound interest rate will fall. In addition, the spot exchange rate (euros per pound) will rise and the forward rate will fall.
    b. Arbitrage transactions. The euro interest rate will fall and the pound interest rate will fall. In addition, the spot exchange rate (euros per pound) will fall and the forward rate will fall as well.
    c. This can be solved by a Central Bank Intervention.
    d. None of the above.

5. Exchange rate daily returns are (usually characterized) for:
    a. Having fat tails when compared to a normal distribution.
    b. Having no tails when compared to a normal distribution.
    c. Presenting clustered volatility.
    d. (a) and (c).
    e. (b) and (c).
    f. None of the above.

Part II: Analysis Questions (1.5 point)

1. Who are the market participants in the foreign exchange market? Be explicit in their role.

2. Due to the integrated nature of their capital markets, investors in both the U.S. and U.K. require the same real interest rate, 2.5%, on their lending. There is a consensus in capital markets that the annual inflation rate is likely to be 3.5% in the U.S. and 1.5% in the U.K. for the next three years. The spot exchange rate is currently $1.50/£.

    a. Compute the nominal interest rate per annum in both the U.S. and U.K., assuming that the Fisher effect holds.
    b. What is your expected future spot dollar-pound exchange rate in three years from now?
    c. Can you infer the forward dollar-pound exchange rate for one-year maturity?

3. Describe the difference between "fundamental" and "technical" analysis of the exchange rate.