Student name:\_\_\_\_\_\_\_\_\_\_

**MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.  
1)** A(n) \_\_\_\_\_\_\_\_ is security issued in the United States that represents shares of a foreign stock and allows that stock to be traded in the United States.

1) \_\_\_\_\_\_

A) American depository receipt   
 B) Yankee bond  
 C) Yankee stock  
 D) Eurostock  
 E) foreign obligation trust certificate

**2)** The \_\_\_\_\_\_\_\_ is the implicit exchange rate between two currencies when both are quoted in a third currency.

2) \_\_\_\_\_\_

A) open exchange rate   
 B) cross-rate  
 C) backward rate  
 D) forward rate  
 E) interest rate

**3)** Money deposited in a financial center outside the country whose currency is involved is called:

3) \_\_\_\_\_\_

A) a foreign depository receipt.   
 B) an international exchange certificate.  
 C) an American depository receipt.  
 D) Eurocurrency.  
 E) Eurodollars.

**4)** The rate most international banks charge one another for overnight Eurodollar loans is the:

4) \_\_\_\_\_\_

A) Eurodollar yield to maturity.   
 B) London Interbank Offered Rate.  
 C) Paris Opening Interest Rate.  
 D) United States Treasury bill rate.  
 E) international prime rate.

**5)** The cross-rate is:

5) \_\_\_\_\_\_

A) the inverse of the direct rate.   
 B) an implicit rate based on two currencies and their individual relationships with a third currency.  
 C) the rate converting the direct rate into the indirect rate.  
 D) the average of the spot and forward rates.  
 E) the link between the spot and forward rates.

**6)** A major network for foreign transactions called \_\_\_\_\_\_\_\_ is operated by a Belgian non-profit cooperative.

6) \_\_\_\_\_\_

A) EURX   
 B) BELX  
 C) SWIFT  
 D) LIBOR  
 E) GLOBEX

**7)** Triangle arbitrage can occur when the \_\_\_\_\_ between two currencies is not \_\_\_\_\_ the ratio of the two direct rates.

7) \_\_\_\_\_\_

A) cross-rate; equal to   
 B) spot rate; equal to  
 C) cross-rate; less than  
 D) spot rate; less than  
 E) cross-rate; greater than

**8)** When the euro is quoted as $1.866, this quote is a(n):

8) \_\_\_\_\_\_

A) triangle rate.   
 B) indirect rate.  
 C) direct rate.  
 D) cross-rate.  
 E) inverse rate.

**9)** When the Mexican peso is quoted as Ps19.9812, this quote is a(n):

9) \_\_\_\_\_\_

A) indirect rate.   
 B) direct rate.  
 C) cross-rate.  
 D) triangle rate.  
 E) linear rate.

**10)** What kind of trade involves agreeing today on an exchange rate for settlement in 90 days?

10) \_\_\_\_\_\_

A) Spot trade   
 B) Market trade  
 C) Forward trade  
 D) Triangle trade  
 E) Complex trade

**11)** The foreign exchange market is where:

11) \_\_\_\_\_\_

A) one country’s stocks are exchanged for another’s.   
 B) one country’s bonds are exchanged for another’s.  
 C) one country’s currency is traded for another’s.  
 D) international banks make loans to one another.  
 E) international businesses finalize import/export relationships with one another.

**12)** The price of one country’s currency, expressed in terms of another country’s currency, is called the:

12) \_\_\_\_\_\_

A) absolute currency rate.   
 B) cross inflation rate.  
 C) depository rate.  
 D) exchange rate.  
 E) foreign interest rate.

**13)** An agreement to trade currencies based on the exchange rate set today, for settlement within two business days is called a(n) \_\_\_\_\_ trade.

13) \_\_\_\_\_\_

A) swap   
 B) option  
 C) futures  
 D) forward  
 E) spot

**14)** Currencies that are exchanged today without any prior arrangement are exchanged at the:

14) \_\_\_\_\_\_

A) spot rate.   
 B) forward rate.  
 C) triangle rate.  
 D) LIBOR.  
 E) discounted rate.

**15)** An agreement to exchange currencies at some moment in the future, using an exchange rate agreed upon today is called a \_\_\_\_\_ trade.

15) \_\_\_\_\_\_

A) spot   
 B) forward  
 C) swap  
 D) floating  
 E) triangle

**16)** Which one of the following statements is true?

16) \_\_\_\_\_\_

A) The exchange markets are limited to the currencies of highly developed countries.   
 B) Importers and exporters are key players in the foreign exchange market.  
 C) The trading floor of the foreign exchange market is located in London, England.  
 D) Foreign exchange rates are set by the governments of each country issuing a currency.  
 E) The foreign exchange market is the world’s smallest financial market.

**17)** Triangle arbitrage:

17) \_\_\_\_\_\_

A) no longer exists due to the advanced electronic communications used in today’s markets.   
 B) applies only to forward exchange rates.  
 C) helps keep the currency market in equilibrium.  
 D) opportunities can only be found in the spot market.  
 E) involves only currencies other than the U.S. dollar.

**18)** Assume the euro is selling in the spot market for $1.19. Simultaneously, in the 3-month forward market the euro is selling for $1.21. Which one of the following statements correctly describes this situation?

18) \_\_\_\_\_\_

A) The spot market is out of equilibrium.   
 B) The forward market is out of equilibrium.  
 C) The dollar is selling at a premium relative to the euro.  
 D) The euro is selling at a premium relative to the dollar.  
 E) The euro is less expensive in the forward market.

**19)** Suppose the spot exchange rate is $1 = £.7230 and the 1-month forward rate is $1 = £.7229. Given this, you know the:

19) \_\_\_\_\_\_

A) U.S. inflation rate is higher than the U.K.’s.   
 B) U.S. nominal interest rate is higher than the U.K.’s.  
 C) pound is selling at a discount.  
 D) U.S. real risk-free interest rate is higher than the U.K.’s.  
 E) pound is selling at a premium.

**20)** Which one of following statements is *false*?

20) \_\_\_\_\_\_

A) Importers are participants in the foreign exchange market.   
 B) The foreign exchange market is an over-the-counter market.  
 C) There are no speculators in the foreign exchange market.  
 D) Exporters are participants in the foreign exchange market.  
 E) Portfolio managers are participants in the foreign exchange market.

**21)** Suppose the one-year forward rate is £.7118. Given no arbitrage opportunities, this implies that traders expect the spot rate to be:

21) \_\_\_\_\_\_

A) £.7118 in one year.   
 B) greater than £.7118 in one year.  
 C) less than £.7118 in one year.  
 D) greater than or equal to £.7118 in one year.  
 E) less than or equal to £.7118 in one year.

**22)** If a foreign currency is selling at a discount relative to the dollar then the:

22) \_\_\_\_\_\_

A) foreign currency is cheaper in the spot market than it is in the forward market.   
 B) cross-rate is cheaper than the direct rate.  
 C) foreign currency is cheaper in the forward market than it is in the spot market.  
 D) direct rate is cheaper than the indirect rate.  
 E) settled rate is less than the spot rate.

**23)** Spot trades must be settled:

23) \_\_\_\_\_\_

A) on the trade date.   
 B) within one business day.  
 C) within two business days.  
 D) within three business days.  
 E) within one week of the trade date.

**24)** Assuming exchange rates are quoted as units of foreign currency per dollar, which one of the following statements is correct?

24) \_\_\_\_\_\_

A) When the dollar strengthens, it takes more dollars to obtain one unit of a foreign currency.   
 B) If the U.S. inflation rate is lower than the inflation rate in Canada, then the U.S. dollar will depreciate relative to the Canadian dollar.  
 C) When a foreign currency appreciates in value it strengthens relative to the dollar.  
 D) As the U.S. dollar strengthens, one British pound will purchase more U.S. dollars.  
 E) The exchange rate is unaffected by differences in the inflation rates of the two countries.

**25)** The idea that a specific hamburger should cost the same regardless of where it is purchased or the currency used to pay it is referred to as:

25) \_\_\_\_\_\_

A) the unbiased forward rates condition.   
 B) uncovered interest rate parity.  
 C) the international Fisher effect.  
 D) absolute purchasing power parity.  
 E) interest rate parity.

**26)** “The change in exchange rates is determined by the difference in the inflation rates of the two countries.” This statement expresses the concept of:

26) \_\_\_\_\_\_

A) absolute purchasing power parity.   
 B) relative purchasing power parity.  
 C) the international Fisher effect.  
 D) unbiased forward rates.  
 E) interest rate parity.

**27)** For absolute purchasing power parity to hold:

27) \_\_\_\_\_\_

A) transaction costs must be observable.   
 B) interest rates must be uniform on a nominal basis.  
 C) inflation rates must be uniform in all markets.  
 D) tariffs must be imposed on all imported goods.  
 E) products must be identical in all markets.

**28)** The symbol “*S*0” represents the:

28) \_\_\_\_\_\_

A) spot exchange rate expressed in dollars per unit of foreign currency.   
 B) forward rate expressed in foreign currency units per dollar.  
 C) profit that can be realized on a triangle arbitrage.  
 D) spot rate in foreign currency units per dollar.  
 E) forward rate expressed in dollars per unit of foreign currency.

**29)** Absolute purchasing power parity is most likely to exist for:

29) \_\_\_\_\_\_

A) a 4-door Ford vehicle.   
 B) a loaf of white bread.  
 C) a 2-bedroom home.  
 D) a new watch.  
 E) an ounce of silver.

**30)** The forward rate is most likely to equal the spot rate when:

30) \_\_\_\_\_\_

A) the real rate of interest is declining.   
 B) the inflation rates in the two countries are equal.  
 C) purchasing power parity exists.  
 D) the real rates of interest in the two countries are equal.  
 E) inflation rates are historically high.

**31)** Which one of the following concepts states that real rates are equal across countries?

31) \_\_\_\_\_\_

A) Uncovered interest parity   
 B) Relative purchasing power parity  
 C) Unbiased forward rates  
 D) Absolute purchasing power parity  
 E) International Fisher effect

**32)** The symbol “*R*FC” represents the foreign country’s:

32) \_\_\_\_\_\_

A) forward nominal market interest rate.   
 B) real risk-free interest rate.  
 C) real market interest rate.  
 D) forward real market interest rate.  
 E) nominal risk-free interest rate.

**33)** Covered interest arbitrage involves:

33) \_\_\_\_\_\_

A) two spot rates.   
 B) two forward rates.  
 C) both a spot rate and a forward rate.  
 D) a single exchange at the current exchange rate.  
 E) a single exchange at a spot rate that exists in the future.

**34)** \_\_\_\_\_ holds because of the possibility of covered interest arbitrage.

34) \_\_\_\_\_\_

A) Uncovered interest parity   
 B) Interest rate parity  
 C) The international Fisher effect  
 D) Unbiased forward rates  
 E) Purchasing power parity

**35)** The condition stating that the interest rate differential between two countries is approximately equal to the percentage forward premium or discount is called:

35) \_\_\_\_\_\_

A) the unbiased forward rates condition.   
 B) uncovered interest rate parity.  
 C) the international Fisher effect.  
 D) purchasing power parity.  
 E) interest rate parity.

**36)** The condition stating that the current forward rate is an unbiased predictor of the future spot exchange rate is called:

36) \_\_\_\_\_\_

A) the unbiased forward rates condition.   
 B) uncovered interest rate parity.  
 C) the international Fisher effect.  
 D) purchasing power parity.  
 E) interest rate parity.

**37)** The condition stating that the expected percentage change in the exchange rate is equal to the difference in interest rates between the countries is called:

37) \_\_\_\_\_\_

A) the unbiased forward rates condition.   
 B) uncovered interest parity.  
 C) the international Fisher effect.  
 D) purchasing power parity.  
 E) interest rate parity.

**38)** Interest rate parity:

38) \_\_\_\_\_\_

A) eliminates covered interest arbitrage opportunities.   
 B) exists when spot rates are equal for multiple countries.  
 C) means that the nominal risk-free rate of return must be the same across countries.  
 D) exists when the spot rate is equal to the futures rate.  
 E) eliminates exchange rate fluctuations.

**39)** The unbiased forward rate is a:

39) \_\_\_\_\_\_

A) condition where a future spot rate is equal to the current spot rate.   
 B) guarantee of a future spot rate at one point in time.  
 C) condition where the spot rate is expected to remain constant over a period of time.  
 D) relationship between the future spot rate of two currencies at an equivalent point in time.  
 E) predictor of the future spot rate at the equivalent point in time.

**40)** The international Fisher effect states that \_\_\_\_\_ rates are equal across countries.

40) \_\_\_\_\_\_

A) spot   
 B) one-year future  
 C) nominal  
 D) inflation  
 E) real

**41)** The home currency approach:

41) \_\_\_\_\_\_

A) discounts all a project’s foreign cash flows using the current spot rate.   
 B) employs uncovered interest parity to project future exchange rates.  
 C) computes the net present value (NPV) of a project in the foreign currency and then converts that NPV into U.S. dollars.  
 D) utilizes the international Fisher effect to compute the NPV of foreign cash flows in the foreign currency.  
 E) utilizes the international Fisher effect to compute the relevant exchange rates needed to compute the NPV of foreign cash flows in U.S. dollars.

**42)** The home currency approach:

42) \_\_\_\_\_\_

A) generally produces more reliable results than those found using the foreign currency approach.   
 B) requires an applicable exchange rate for every time period for which there is a cash flow.  
 C) uses the current risk-free nominal rate to discount all the cash flows related to a project.  
 D) stresses the use of the real rate of return to compute the net present value (NPV) of a project.  
 E) converts the foreign-denominated NPV into the dollar-denominated NPV.

**43)** The foreign currency approach to capital budgeting analysis:

43) \_\_\_\_\_\_

A) is computationally harder to use than the home currency approach.   
 B) utilizes the uncovered interest parity relationship.  
 C) computes the NPV in both the foreign and the domestic currency.  
 D) is solely dependent upon purchasing power parity.  
 E) produces superior results as compared to the home currency approach.

**44)** Remitting funds to a parent firm from a foreign subsidiary is referred to as:

44) \_\_\_\_\_\_

A) recommitting.   
 B) reshipping.  
 C) repatriating.  
 D) reminding.  
 E) reshaping.

**45)** Which one of the following factors does *not* tend to hinder funds from foreign subsidiaries being remitted to their home country parent firm?

45) \_\_\_\_\_\_

A) Foreign exchange remittance controls   
 B) Repatriation taxes  
 C) Active exchange rate market  
 D) Blocking controls  
 E) Expropriation taxes

**46)** An international firm that imports raw materials can reduce its \_\_\_\_\_ exposure to \_\_\_\_\_ rate risk by entering into a forward contract.

46) \_\_\_\_\_\_

A) long-term; inflation   
 B) short-term; inflation  
 C) short-run; exchange  
 D) long-run; exchange  
 E) total; interest

**47)** The changes in the relative economic conditions between countries are referred to as the:

47) \_\_\_\_\_\_

A) international Fisher effect.   
 B) international exchange rate effect.  
 C) translation exposure to exchange rate risk.  
 D) long-run exposure to exchange rate risk.  
 E) the interest rate parity risk.

**48)** Which one of the following statements is correct?

48) \_\_\_\_\_\_

A) Borrowing money in the country in which operations are located reduces long-run exchange rate risk.   
 B) Accounting translation gains are recorded on the income statement as other income.  
 C) In multidivisional firms, exchange rate risk should be managed at the division level.  
 D) The usage of forward rates can help reduce the long-run exposure to exchange rate risk.  
 E) Unexpected changes in economic conditions are classified as short-run exposure to exchange rate risk.

**49)** Financial Accounting Standards Board Statement No. 52 requires that most assets and liabilities be translated at the current exchange rate. Translation gains and losses are recorded:

49) \_\_\_\_\_\_

A) in the shareholders' equity section of the balance sheet.   
 B) as a normal income item on the income statement.  
 C) as an extraordinary item on the income statement.  
 D) as a footnote to the financial statements.  
 E) only on income tax returns.

**50)** A foreign subsidiary can remit funds to the parent firm in all the following ways *except* by means of:

50) \_\_\_\_\_\_

A) dividends.   
 B) management fees for central services.  
 C) royalties on the use of trade names.  
 D) royalties on the use of patents.  
 E) nationalization.

**51)** All the following are political risks associated with international investing *except:*

51) \_\_\_\_\_\_

A) nationalization.   
 B) decreasing consumer demand.  
 C) blocking of funds.  
 D) tax law changes.  
 E) contract abrogation.

**52)** Monies earned by foreign subsidiaries that have not yet been taxed under U.S. law can be used to:

52) \_\_\_\_\_\_

A) purchase U.S. government bonds.   
 B) purchase U.S. stocks.  
 C) pay dividends.  
 D) invest in new capital overseas.  
 E) invest in new U.S. plants and equipment.

**53)** The Tax Cut and Jobs Act of 2017 allows untaxed foreign profits that are held as cash or as securities to be:

53) \_\_\_\_\_\_

A) used to purchase U.S. fixed assets after a one-time tax of 8 percent.   
 B) repatriated at a one-time tax rate of 15.5 percent.  
 C) returned to the U.S. at the new corporate tax rate of 15 percent.  
 D) repatriated at a one-time tax rate of 8 percent.  
 E) returned to the U.S. as tax-free income.

**54)** How many euros can you get for $2,500 if the USD equivalent is 1.2195?

54) \_\_\_\_\_\_

A) €2,147.08   
 B) €2,050.02  
 C) €2,309.11  
 D) €3,048.75  
 E) €2,921.00

**55)** Sowmiya is planning a trip to Australia. The hotel will cost A$215 per night for ten nights. She expects to spend another A$2,500 for meals, tours, souvenirs, and so forth. How much will this trip cost her in U.S. dollars if the USD equivalent is .7412?

55) \_\_\_\_\_\_

A) $6,273.61   
 B) $3,446.58  
 C) $3,317.54  
 D) $1,623.61  
 E) $2,901.43

**56)** A firm intends to import $65,000 worth of rugs from India. How many rupees does the firm need to pay for this purchase if one rupee is worth $.0137?

56) \_\_\_\_\_\_

A) Rs4,744,526   
 B) Rs891  
 C) Rs62,903  
 D) Rs64,110  
 E) Rs21,077

**57)** Assume $1 will buy Can$1.2562 while $1.1860 will buy €1. What is the Can$/€ exchange rate? €1 =

57) \_\_\_\_\_\_

A) Can$.9441   
 B) Can$.9349  
 C) Can$1.0592  
 D) Can$1.4899  
 E) Can$1.2161

**58)** Assume that ¥106.83 equals $1. Also assume that SKr8.2941 equals $1. How many Japanese yen can you acquire in exchange for 5,000 Swedish krona?

58) \_\_\_\_\_\_

A) ¥388.19   
 B) ¥314.77  
 C) ¥41,710.99  
 D) ¥56,756.67  
 E) ¥64,401.20

**59)** You just returned from some extensive traveling. You started your trip with $10,000 in your pocket. You spent 1.32 million pesos in Chile where Ps1 = $.001642. You spent Ps36,000 in Uruguay where Ps1 = $.03526. Then on the way home, you spent Ps29,000 in Mexico where $1 = Ps18.8709. How many dollars did you have left by the time you returned to the U.S.?

59) \_\_\_\_\_\_

A) $3,889.07   
 B) $4,001.84  
 C) $4,110.27  
 D) $5,026.44  
 E) $4,299.03

**60)** Assume the official USD equivalent of one Canadian dollar is .7813 and the USD equivalent of the U.K. pound is 1.3699. Further assume you have 100 pounds and have been offered Can$180 for them. If you use triangle arbitrage and the entire £100, you can earn a profit of:

60) \_\_\_\_\_\_

A) £1.56.   
 B) £2.66.  
 C) £.87.  
 D) £1.09.  
 E) £2.03.

**61)** Zanir has been offered Can$1.75 for £1. How much profit can she earn on a triangle arbitrage if the official rate is $1 = Can$1.2834 and the USD equivalent of £1 is $1.3699? Assume she currently has $100 in cash.

61) \_\_\_\_\_\_

A) $.46   
 B) $.73  
 C) $1.09  
 D) $1.37  
 E) $.57

**62)** Assume you can exchange $1 for £.7347 today. Assume that last week, £1 was worth $1.3613. If you had converted £100 into dollars last week and then exchanged your dollars back into pounds today, you would now have a:

62) \_\_\_\_\_\_

A) profit of $.048.   
 B) loss of $. 42.  
 C) profit of £.101.  
 D) loss of $.068.  
 E) profit of £.015.

**63)** Assume today you can exchange $100 for either Can$128 or Ps1,892. Also assume that last year, $100 was worth Can$126 or Ps1,847. Which one of the following statements is correct given this information?

63) \_\_\_\_\_\_

A) $100 invested in Canadian dollars last year would now be worth Ps1,824.09.   
 B) $100 invested in Mexican pesos last year would now be worth $98.47.  
 C) $100 invested in Mexican pesos last year would now be worth $101.63.  
 D) $100 invested in Canadian dollars last year would now be worth $99.52.  
 E) $100 invested in Canadian dollars last year would now be worth Ps1,862.44.

**64)** The cell phone you want to buy costs $699 in the U.S. If absolute purchasing power parity exists, and if the exchange rate is €1= $1.1860, the same cell phone will cost \_\_\_\_\_\_\_\_ in Germany.

64) \_\_\_\_\_\_

A) €612.13   
 B) €1,206.25  
 C) €1,696.71  
 D) €829.01  
 E) €589.38

**65)** Assume the cost of a nice dinner in a restaurant in Singapore costs S$75. Also assume S$1 = $.7445 and €1 = $1.1860. How much will the identical meal cost in euros if absolute purchasing power parity exists?

65) \_\_\_\_\_\_

A) €100.74   
 B) €88.95  
 C) €47.08  
 D) €66.22  
 E) €119.48

**66)** Assume $1 = ¥106.83 = £.7309. If a TV in London costs £430, what will that identical TV cost in Tokyo if absolute purchasing power parity exists?

66) \_\_\_\_\_\_

A) ¥32,411.02   
 B) ¥34,666.67  
 C) ¥62,849.77  
 D) ¥58,001.28  
 E) ¥82,880.09

**67)** Assume the spot market exchange rate for $1 is currently A$1.3512. Also assume the expected inflation rate is 2.6 percent in Australia compared to the U.S. rate of 3.2 percent. What is the expected exchange rate one year from now if relative purchasing power parity exists?

67) \_\_\_\_\_\_

A) A$1.3431   
 B) A$1.3572  
 C) A$1.3863  
 D) A$1.2967  
 E) A$1.3944

**68)** Assume the spot rate of $1 is £.7230. Also assume the expected inflation rate in the U.K. is 2.8 percent while the U.S. inflation rate is 3.6 percent. What is the expected exchange rate two years from now if relative purchasing power parity exists?

68) \_\_\_\_\_\_

A) £.9841   
 B) £.7115  
 C) £.7346  
 D) £.7058  
 E) £.4982

**69)** Assume the current spot rate is Can$1.2803 and the one-year forward rate is Can$1.2745. Also assume the nominal risk-free rate in Canada is 4.8 percent while it is 4.2 percent in the U.S. Using covered interest arbitrage, you can earn a profit of \_\_\_ for every $1 invested over the next year.

69) \_\_\_\_\_\_

A) $.0163   
 B) $.0108  
 C) −$.0040  
 D) −$.0088  
 E) −$.0840

**70)** Assume the current spot rate is Can$1.2811 and the one-year forward rate is Can$1.2767. Also assume the nominal risk-free rate in Canada is 3.2 percent while the U.S. rate is 3.5 percent. Using covered interest arbitrage you can earn an extra profit of \_\_\_ for every $1 invested over the next year.

70) \_\_\_\_\_\_

A) $.0018   
 B) $.0015  
 C) $.0011  
 D) $.0006  
 E) $.0002

**71)** Assume the spot rate for the Japanese yen currently is ¥106.83 per dollar while the one-year forward rate is ¥107.20. Also assume a risk-free asset in Japan is currently earning 4.6 percent. If interest rate parity holds, approximately what rate can you earn on a one-year risk-free U.S. security?

71) \_\_\_\_\_\_

A) 4.24%   
 B) 5.08%  
 C) 4.62%  
 D) 4.78%  
 E) 4.96%

**72)** Assume the spot rate for the British pound currently is £.7287 per dollar and the one-year forward rate is £.7304. A risk-free asset in the U.S. is currently earning 3 percent. If interest rate parity holds, approximately what rate can you earn on a one-year risk-free British security?

72) \_\_\_\_\_\_

A) 3.16%   
 B) 3.03%  
 C) 2.92%  
 D) 2.84%  
 E) 3.24%

**73)** Assume a risk-free asset in the U.S. is currently yielding 2.7 percent while a Canadian risk-free asset is yielding 2.8 percent and the current spot rate is Can$1.2849 = $1. What is the approximate 6-month forward rate if interest rate parity holds?

73) \_\_\_\_\_\_

A) Can$1.2855   
 B) Can$1.2838  
 C) Can$1.2843  
 D) Can$1.2862  
 E) Can$1.2836

**74)** Suppose the spot rate on the Indian rupee is Rs65.2203, the risk-free nominal rate in the U.S. is 4.6 percent, and the Indian risk-free nominal rate is 6.2 percent. Which one of the following one-year forward rates best establishes the approximate interest rate parity condition?

74) \_\_\_\_\_\_

A) Rs64.1768   
 B) Rs66.2638  
 C) Rs62.8840  
 D) Rs63.0733  
 E) Rs67.8420

**75)** Suppose the spot rate on the Canadian dollar is C$1.2797. Also assume the risk-free nominal rate in the U.S. is 3.8 percent while it is only 3.3 percent in Canada. Which one of the following three-year forward rates best establishes the approximate interest rate parity condition?

75) \_\_\_\_\_\_

A) C$1.2733   
 B) C$1.2606  
 C) C$1.2861  
 D) C$1.2990  
 E) C$1.1918

**76)** You are considering a project in Norway with an initial cost of NKr135,000. The project is expected to return a one-time payment of NKr200,000 at the end of Year 5. Assume the risk-free rate of return is 2.6 percent in the U.S. and 3.1 percent in Norway. Assume the inflation rate is 1.6 percent in the U.S. and 2.3 percent in Norway. Lastly, assume the current exchange rate is $1 = NKr7.9271. Approximately how much will the payment at the end of 5 Years be worth in U.S. dollars?

76) \_\_\_\_\_\_

A) $24,609   
 B) $24,108  
 C) $26,472  
 D) $25,870  
 E) $26,006

**77)** You are expecting a payment of Can$138,000 two years from now. Assume the risk-free rate of return is 2.7 percent in Canada and 3.1 percent in the U.S. Also assume the current exchange rate is Can$1.2903 = $1. Approximately how much will the payment two years from now be worth in U.S. dollars?

77) \_\_\_\_\_\_

A) $108,319   
 B) $106,101  
 C) $107,813  
 D) $107,381  
 E) $108,169

**78)** Assume the current spot rate for the Norwegian krone is $1 = NKr7.9323, the expected inflation rate in Norway is 2.1 percent and 1.2 percent in the U.S. Also assume a risk-free asset in the U.S. is yielding 3.7 percent. What nominal risk-free rate of return should you expect on a Norwegian security?

78) \_\_\_\_\_\_

A) 2.9%   
 B) 4.6%  
 C) 4.2%  
 D) 3.1%  
 E) 3.8%

**79)** Assume the current spot rate for the Norwegian krone is $1 = NKr7.93, the expected inflation rate in Norway is 2.4 percent while it is 2.6 percent in the U.S. Also assume a risk-free asset in the U.S. is yielding 4.5 percent. What real rate of return should you expect on a risk-free Norwegian security?

79) \_\_\_\_\_\_

A) 4.3%   
 B) 4.7%  
 C) 1.9%  
 D) 2.1%  
 E) 2.4%

**80)** Assume the expected inflation rate in Finland is 2 percent while it is 4 percent in the U.S. Also assume a risk-free asset in the U.S. is yielding 4.5 percent. What nominal rate of return should you expect on a risk-free Finnish security?

80) \_\_\_\_\_\_

A) 2.0%   
 B) 1.5%  
 C) 3.0%  
 D) 2.5%  
 E) 4.0%

**81)** Assume the expected inflation rate in Switzerland is 2.2 percent while it is 1.6 percent in the U.S. Also assume a risk-free asset in the U.S. is yielding 3.7 percent. What real rate of return should you expect on a risk-free Swiss security?

81) \_\_\_\_\_\_

A) 2.0%   
 B) 2.1%  
 C) 3.0%  
 D) 3.5%  
 E) 3.1%

**82)** A Canadian project has an initial cost of Can$1.8 million and is expected to produce cash inflows of Can$710,000 per year for 3 years after which time it will be worthless. Assume the expected inflation rate in Canada is 4 percent while it is only 3 percent in the U.S. The applicable interest rate in Canada is 8 percent. Assume the current spot rate is C$1 = $.78. What is the net present value of this project in Canadian dollars using the foreign currency approach?

82) \_\_\_\_\_\_

A) Can$33,974.02   
 B) Can$32,790.05  
 C) Can$29,738.86  
 D) Can$28,721.40  
 E) Can$30,751.18

**83)** Global Markets wants to invest in a riskless project in Sweden. The project has an initial cost of SKr2.3 million and is expected to produce cash inflows of SKr850,000 per year for 3 years. The project will be worthless after the first 3 years. Assume the expected inflation rate in Sweden is 2.6 percent while it is 3.2 percent in the U.S. Also assume a risk-free security is paying 5.9 percent in the U.S. and the current spot rate is $1 = SKr8.31. What is the net present value of this project in Swedish krona using the foreign currency approach? Assume the international Fisher effect applies.

83) \_\_\_\_\_\_

A) SKr1,856.07   
 B) SKr1,809.85  
 C) SKr1,969.10  
 D) SKr1,978.67  
 E) SKr2,028.18

**84)** A project has an initial cost of £1.2 million and expected cash inflows of £400,000, £500,000, and £600,000 for Years 1 to 3, respectively. Assume the current spot rate is £.73 and the nominal risk-free returns are 4 percent in the U.K. and 3 percent in the U.S. If uncovered interest rate parity exists, what is the net present value of this project in U.S. dollars using the home currency approach? Assume the project’s U.S. discount rate is 12 percent.

84) \_\_\_\_\_\_

A) −$56,359   
 B) −$104,040  
 C) −$71,067  
 D) $26,422  
 E) $92,009

**85)** A project has an initial cost of £80,000 and is expected to return £10,000 the first year, £40,000 the second year, and £50,000 the third and final year. Assume the current spot rate is £.75. Also assume the nominal risk-free return is 3 percent in the U.K. and 5 percent in the U.S. The return relevant to the project is 7.8 percent in the U.K. and 8.1 percent in the U.S. Assume uncovered interest rate parity exists. What is the net present value of this project in U.S. dollars using the home currency approach?

85) \_\_\_\_\_\_

A) $9,787   
 B) $11,002  
 C) $10,312  
 D) $10,511  
 E) $9,514

**86)** The exchange rate is 1.21 Swiss francs per dollar. How many U.S. dollars are needed to purchase 6,000 Swiss francs?

86) \_\_\_\_\_\_

A) $4,507.89   
 B) $7,530.00  
 C) $6,109.34  
 D) $4,958.68  
 E) $6,109.34  
 F) $7,260.00

**87)** The exchange rate is .7663 U.S. dollars per Brazilian real. How many U.S. dollars are needed to purchase 8,200 Brazilian reals?

87) \_\_\_\_\_\_

A) $9,727.97   
 B) $6,553.66  
 C) $6,283.66  
 D) $10,700.77  
 E) $8,492.21

**88)** You are planning a trip to the United Kingdom and expect that you will spend 3,400 pounds. How much will your spending be in U.S. dollars if the exchange rate is .7485 pounds per dollar?

88) \_\_\_\_\_\_

A) $4,129.47   
 B) $3,543.66  
 C) $2,544.90  
 D) $4,542.42  
 E) $2,814.90

**89)** You just returned from a trip to Italy and have 860 euros remaining. How many dollars will you receive when you return home if the exchange rate is .9210 euros per U.S dollar?

89) \_\_\_\_\_\_

A) $826.03   
 B) $792.06  
 C) $933.77  
 D) $988.70  
 E) $904.26

**90)** Your German friend has decided to come visit you in the U.S. You estimate the cost of her trip will be $3,000. What is the cost of her trip in euros if the U.S. dollar equivalent of the euro is 1.1346?

90) \_\_\_\_\_\_

A) €2,504.94   
 B) €2,644.10  
 C) €3,403.80  
 D) €3,201.90  
 E) €2,735.28

**91)** You can exchange $1 for either .8970 euro or .7185 British pounds. What is the cross-rate in terms of pounds per euro?

91) \_\_\_\_\_\_

A) £.6445/€   
 B) £1.2484/€  
 C) £.7120/€  
 D) £1.1524/€  
 E) £.8010/€

**92)** You can exchange $1 for either Can$1.1227 or ¥105.37. What is the cross-rate between the Canadian dollar and Japanese yen?

92) \_\_\_\_\_\_

A) Can$.0107/¥   
 B) Can$118.2989/¥  
 C) Can$93.8541/¥  
 D) Can$.0098/¥  
 E) Can$83.4259/¥

**93)** Currently, you can purchase either 128 Canadian dollars or 11,825 Japanese yen per $100. What is the yen/Canadian dollar cross-rate?

93) \_\_\_\_\_\_

A) ¥.0135/Can$   
 B) ¥.0100/Can$  
 C) ¥92.3828/Can$  
 D) ¥97.5152/Can$  
 E) ¥.0108/Can$

**94)** The spot rate for the British pound is £.7169 = $1 and the Canadian dollar is Can$1.0717 = $1. What is the £/Can$ cross-rate?

94) \_\_\_\_\_\_

A) £.6689/Can$   
 B) £.6175/Can$  
 C) £1.4949/Can$  
 D) £1.5780/Can$  
 E) £.8362/Can$

**95)** Currently, you can exchange $1 for either ¥106.55 or €.7592 in New York. In Tokyo, the exchange rate is ¥/€.0072. If you have $1,500, how much profit can you earn with triangle arbitrage?

95) \_\_\_\_\_\_

A) $17.47   
 B) $14.52  
 C) $19.66  
 D) $16.55  
 E) $15.73

**96)** The exchange rates in New York for $1 are Can$1.0977 or £.7287. In Toronto, Can$1 will buy £.6728. How much profit can you earn on $10,000 using triangle arbitrage?

96) \_\_\_\_\_\_

A) $134.93   
 B) $168.67  
 C) $127.44  
 D) $124.55  
 E) $142.03

**97)** Your favorite running shoes cost $100 in the U.S. while the identical shoes cost Can$120.90 in Canada. According to absolute purchasing power parity, what is the Can$/$ exchange rate?

97) \_\_\_\_\_\_

A) Can$1.2954/$   
 B) Can$1.2574/$  
 C) Can$.8631/$  
 D) Can$.8271/$  
 E) Can$1.2090/$

**98)** A ski resort hotel room in Switzerland costs SF375. A ski resort hotel room in Colorado costs $355. Assuming the slopes and hotel rooms are identical, what is the Swiss franc/U.S. dollar exchange rate?

98) \_\_\_\_\_\_

A) SF.9467/$   
 B) SF1.0563/$  
 C) SF.9878/$  
 D) SF1.1318/$  
 E) SF1.0986/$

**99)** A set of golf clubs costs $1,025 in the United States. The current exchange rate is $1.3594/£. Assuming absolute purchasing power parity holds, what is the price of the clubs in Scotland?

99) \_\_\_\_\_\_

A) £1,393.39   
 B) £754.01  
 C) £784.17  
 D) £1,323.72  
 E) £807.87

**100)** The current spot rate between the pound and dollar is £.7556/$. The expected inflation rate in the U.S is 2.39 percent and the expected inflation rate in the U.K. is 2.93 percent. Assuming relative purchasing power parity holds, what will the exchange rate be next year?

100) \_\_\_\_\_\_

A) £.7901/$   
 B) £.7958/$  
 C) £.7901/$  
 D) £.7515/$  
 E) £.7597/$

**101)** The current spot rate between the euro and dollar is €1.1053/$. The annual inflation rate in the U.S is expected to be 1.69 percent and the annual inflation rate in euroland is expected to be 3.07 percent. Assuming relative purchasing power parity holds, what will the exchange rate be in two years?

101) \_\_\_\_\_\_

A) €1.0900/$   
 B) €1.0750/$  
 C) €1.1360/$  
 D) €1.1517/$  
 E) €1.1206/$

**102)** The annual inflation rate in the U.S is expected to be 2.73 percent and the annual inflation rate in Poland is expected to be 4.23 percent. The current spot rate between the zloty and dollar is Z4.1004/$.Assuming relative purchasing power parity holds, what will the exchange rate be in four years?

102) \_\_\_\_\_\_

A) Z3.9186/$   
 B) Z4.3520/$  
 C) Z4.2877/$  
 D) Z3.8599/$  
 E) Z4.2243/$

**103)** The spot rate between Canada and the U.S. is Can$1.2386/$, while the one-year forward rate is Can$1.2385/$. The risk-free rate in Canada is 2.85 percent and risk-free rate in the United States is 2.56 percent. How much in profit can you earn on $7,000 utilizing covered interest arbitrage?

103) \_\_\_\_\_\_

A) $18.27   
 B) $22.18  
 C) $16.71  
 D) $19.72  
 E) $20.88

**104)** The spot rate between the U.K. and the U.S. is £.7574/$, while the one-year forward rate is £.7532/$. The risk-free rate in the U.K. is 4.43 percent and risk-free rate in the United States is 2.66 percent. How much in profit can you earn on $7,000 utilizing covered interest arbitrage?

104) \_\_\_\_\_\_

A) $144.08   
 B) $164.66  
 C) $93.78  
 D) $83.36  
 E) $131.73

**105)** The one-year forward rate for the Swiss franc is SF1.1601/$. The spot rate is SF1.1716/$. The interest rate on a risk-free asset in Switzerland is 2.95 percent. If interest rate parity exists, what is the one-year risk-free rate in the U.S.?

105) \_\_\_\_\_\_

A) 3.18%   
 B) 3.47%  
 C) 3.97%  
 D) 1.94%  
 E) 3.72%

**106)** The spot rate between the Japanese yen and the U.S. dollar is ¥106.70/$, while the one-year forward rate is ¥105.83/$. The one-year risk-free rate in the U.S. is 2.43 percent. If interest rate parity exists, what is the one-year risk-free rate in Japan?

106) \_\_\_\_\_\_

A) 2.86%   
 B) 3.27%  
 C) 1.59%  
 D) 1.42%  
 E) 3.07%

**107)** Assume interest rate parity holds. The one-year risk-free rate in the U.S. is 3.70 percent and the one-year risk-free rate in Japan is 4.05 percent. The spot rate between the Japanese yen and the U.S. dollar is ¥113.49/$. What is the one-year forward exchange rate?

107) \_\_\_\_\_\_

A) ¥113.87/$   
 B) ¥115.74/$  
 C) ¥113.49/$  
 D) ¥113.11/$  
 E) ¥116.71/$

**108)** The one-year risk-free rate in the U.S. is 1.96 percent and the one-year risk-free rate in Mexico is 3.56 percent. The one-year forward rate between the Mexican peso and the U.S. dollar is MXN12.18/$. What is the spot exchange rate? Assume interest rate parity holds.

108) \_\_\_\_\_\_

A) MXN13.866/$   
 B) MXN14.836/$  
 C) MXN11.996/$  
 D) MXN12.375/$  
 E) MXN12.184/$

**109)** A U.S. firm has total assets valued at €848,000 located in Germany. This valuation did not change from last year. Last year, the exchange rate was €.9482/$. Today, the exchange rate is €.9009/$. By what amount did these assets change in value on the firm's U.S. financial statements?

109) \_\_\_\_\_\_

A) $46,954.85   
 B) $40,110.40  
 C) −$40,110.40  
 D) −$46,954.85  
 E) $0

**110)** Last year, the Mexican peso/U.S. dollar exchange rate was MXN13.3563/$. Today, the exchange rate is MXN16.1974/$. A U.S. firm has total assets worth MXN14,460,000 located in Mexico that did not change in value over the year. What was the change in the value of the assets in dollars on the company's U.S. balance sheet?

110) \_\_\_\_\_\_

A) −$173,548.15   
 B) −$189,899.29  
 C) $173,548.15  
 D) $189,899.29  
 E) $0

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.  
111)** Explain the difference between a spot trade and a forward trade as they relate to currencies.

**112)** What is triangle arbitrage?

**113)** How well do you think relative purchasing power parity and uncovered interest parity behave? That is, do you think it's possible to forecast the expected future spot exchange rate accurately? What complications might you run into?

**114)** What is required for absolute purchasing power parity to hold? Do you think absolute PPP would hold in the case where a shoe retailer in the U.S. sits directly across the border from a shoe retailer in Canada? How about Houston, Texas, and London, England?

**115)** Describe the foreign currency and home currency approaches to capital budgeting. Which is better? Which approach would you recommend a U.S. firm use? Justify your answer.

**Answer Key**Test name: Chapter 31

1) A

2) B

3) D

4) B

5) B

6) C

7) A

8) C

9) A

10) C

11) C

12) D

13) E

14) A

15) B

16) B

17) C

18) D

19) E

20) C

21) A

22) C

23) C

24) C

25) D

26) B

27) E

28) D

29) E

30) B

31) E

32) E

33) C

34) B

35) E

36) A

37) B

38) A

39) E

40) E

41) B

42) B

43) C

44) C

45) C

46) C

47) D

48) A

49) A

50) E

51) B

52) D

53) B

54) B

Number of euros = $2,500(€1/$1.2195)  
 Number of euros = €2,050.02

55) B

Cost of trip = [A$215(10) + A$2,500]($.7412/A$1)  
 Cost of trip = $3,446.58

56) A

Purchase cost = $65,000(Rs1/$.0137)  
 Purchase cost = Rs4,744,526

57) D

Setting the algebra up so the $ signs cancel out:  
   
 Can$/€: (Can$1.2562/$1)($1.1860/€1)  
 Can$/€: Can$1.4899 = 1€

58) E

Number of yen = SKr5,000(¥106.83/SKr8.2941)  
 Number of yen = ¥64,401.20

59) D

Funds remaining = $10,000 − Ps1,320,000($.001642/Ps1) − Ps36,000($.03526/Ps1) − Ps29,000($1/Ps18.8709)  
 Funds remaining = $5,026.44

60) B

Profit = [£100(Can$180/£100)($.7813/Can$1)(£1/$1.3699)] − £100  
 Profit = £2.66

61) A

Profit = [$100(Can$1.2834/$1)(£1/Can$1.75)($1.3699/£1)] − $100  
 Profit = $.46

62) E

Profit = [£100($1.3613/£1)(£.7347/$1)] − £100  
 Profit = £.015

63) E

Current value in Ps of $100 exchanged to Can$ last year = $100(Can$126/$100)($100/Can$128)(Ps1,892/$100)  
 Current value in Ps of $100 exchanged to Can$ last year = Ps1,862.44  
   
 Current value in dollars of $100 exchanged to Ps last year = $100(Ps1,847/$100)($100/Ps1,892)  
 Current value in dollars of $100 exchanged to Ps last year = $97.62  
   
 Current value in dollars of $100 exchanged to Can$ last year = $100(Can$126/$100)($100/Can$128)  
 Current value in dollars of $100 exchanged to Can$ last year = $98.44

64) E

Cost in Germany = $699(€1/$1.1860)  
 Cost in Germany = €589.38

65) C

Cost in euros = S$75($.7445/S$1)(€1/$1.1860)  
 Cost in euros = €47.08

66) C

Cost in yen = £430($1/£.7309)(¥106.83/$1)  
 Cost in yen = ¥62,849.77

67) A

E(*S*1) = A$1.3512[1 + (.026 − .032)]1  
 E(*S*1) = A$1.3431

68) B

E(*S*2) = £.7230[1 + (.028 − .036)]2  
 E(*S*2) = £.7115

69) B

Arbitrage profit = [($1)(C$1.2803/$1)(1.048)($1/C$1.2745)] − $1(1.042)  
 Arbitrage profit = $.0108

70) D

Arbitrage profit = [($1)(Can$1.2811/$1)(1.032)($1/Can$1.2767)] − $1(1.035)  
 Arbitrage profit = $.0006

71) A

(¥107.20/¥106.83) = [1.046/(1 + *R*US)]  
 *R*US = .0424, or 4.24%

72) E

(£.7304/£.7287) = (1 + *RFc*)/1.03  
 *RFC* = .0324, or 3.24%

73) A

ƒ.5 = Can$1.2849[1 + (.028 −.027)].5  
 ƒ.5 = Can$1.2855

74) B

ƒ1 ≅ Rs65.2203[1 + (.062 − .046)]1  
 ƒ1 ≅ Rs66.2638

75) B

ƒ3 ≅ C$1.2797[1 + (.033 − .038)]3  
 ƒ3 ≅ C$1.2606

76) A

E(*S*5) = (NKr7.9271/$1)[1 + (.031 − .026)]5  
 E(*S*5) = NKr8.1273  
   
 Payment value = NKr200,000($1/NKr8.1273)  
 Payment value = $24,609

77) C

E(*S*2) = Can$1.2903[1 + (.027 − .031)]2  
 E(*S*2) = Can$1.2800  
   
 Payment value = Can$138,000($1/Can$1.2800)  
 Payment value = $107,813

78) B

.037 − .012 = *R*FC − .021  
 *R*FC = .046, or 4.6%

79) C

Real rate = .045 − .026  
 Real rate = .019, or 1.9%

80) D

.045 − .04 = *R*FC − .02  
 *R*FC = .025, or 2.5%

81) B

Real rate = .037 − .016  
 Real rate = .021, or 2.1%

82) C

NPV = −Can$1,800,000 + Can$710,000(PVIFA8%,3)  
 NPV = Can$29,738.86

83) B

.059 − .032 = *R*FC − *.*026  
 *R*FC = .053  
   
 NPV = –SKr2,300,000 + SKr850,000(PVIFA5.3%,3)  
 NPV = SKr1,809.85

84) A

E(*S*1) = £.73[1 + (.04 − .03)]1 = £.7373  
 E(*S*2) = £.73[1 + (.04 − .03)]2 = £.744673  
 E(*S*3) = £.73[1 + (.04 − .03)]3 = £.752120  
   
 CF0 = −£1,200,000($1/£.73) = −$1,643,835.62  
 CO1 = £400,000($1/£.7373) = $542,520.01  
 CO2 = £500,000($1/£.744673) = $671,435.65  
 CO3 = £600,000($1/£.752120) = $797,745.04  
   
 NPV = −$1,643,835.62 + ($542,520.01/1.12) + ($671,435.65/1.122) + ($797,745.04/1.123)  
 NPV = −$56,359

85) E

E(*S*1) = £.75[1 + (.03 − .05)]1 = £.7350  
 E(*S*2) = £.75[1 + (.03 − .05)]2 = £.7203  
 E(*S*3) = £.75[1 + (.03 − .05)]3 = £.705894  
   
 CF0 = −£80,000($1/£.75) = −$106,666.67  
 CO1 = £10,000($1/£.7350) = $13,605.44  
 CO2 = £40,000($1/£.7203) = $55,532.42  
 CO3 = £50,000($1/£.705894) = $70,832.16  
   
 NPV = −$106,666.67 + ($13,605.44/1.081) + ($55,532.42/1.0812) + ($70,832.16/1.0813)  
 NPV = $9,514

86) D

Dollars needed = SF6,000($1/SF1.21)  
 Dollars needed = $4,958.68

87) C

Dollars needed = Real 8,200(.7663$ per Real)  
 Dollars needed = $6,283.66

88) D

Dollars needed = £3,400($1/£.7485)  
 Dollars needed = $4,542.42

89) C

Dollars needed = €860($1/€.9210)  
 Dollars needed = $933.77

90) B

Euros needed = $3,000(€/$1.1346)  
 Euros needed = €2,644.10

91) E

£.7185 = €.8970  
 £.8010/€

92) A

Can$1.1227 = ¥105.3700  
 Can$.0107/¥

93) C

¥11,825 = Can$128  
 ¥92.3828/Can$

94) A

£.7169 = Can$1.0717  
 £.6689/Can$

95) E

Profit = [$1,500(¥106.55/$1)(€.0072/¥)($1/€.7592)] − $1,500  
 Profit = $15.73

96) A

Profit = [$10,000(Can$1.0977/$1)(($1/£.7287)(£.6728/Can$1)] − $10,000  
 Profit = $134.93

97) E

Can$120.90/$100  
 Can$1.2090/$

98) B

SF375 = $355  
 SF1.0563/$

99) B

Price = $1,025(£/$1.3594)  
 Price = £754.01

100) E

Forward rate = £.7556[1 + (.0293 − .0239)]  
 Forward rate = £.7597

101) C

Forward rate = €1.1053[1 + (.0307 − .0169)]2  
 Forward rate = €1.1360

102) B

Forward rate = Z4.1004[1 + (.0423 − .0273)]4  
 Forward rate = Z4.3520

103) E

Profit = $7,000(Can$1.2386/$)(1.0285)($/Can$1.2385) − $7,000(1.0256)  
 Profit = $20.88

104) B

Profit = $7,000(£.7574/$)(1.0443)($/£.7532) − $7,000(1.0266)  
 Profit = $164.66

105) C

1.1601/1.1716 = 1.0295/(1 + *R*US)  
 *R*US = .0397, or 3.97%

106) C

105.83/106.70 = (1 + *R*J)/1.0243  
 *R*J = .0159, or 1.59%

107) A

*F1/S0 = F1*/¥113.49 = 1.0405/1.0370  
 *F* = ¥113.87/$

108) D

F1/S0 = MXN12.184/S0 = 1.0356/1.0196  
 *S*0= MXN12.375/$

109) A

Change = €848,000($/€.9009) − €848,000($/€.9482)  
 Change = $46,954.85

110) B

Change = MXN14,460,000($/€16.1974) − MXN14,460,000($/€13.3563)  
 Change = −$189,899.29

111) A spot trade is an agreement made today to exchange currencies today at the current, or spot, exchange rate. A forward trade is an agreement today to exchange currencies on some future date at a price (forward rate) agreed upon today.

112) Triangle arbitrage is the ability to earn a risk-free profit when the cross-rate between two currencies, let’s say A and B, differs from the rate implied by exchanging currency A into a third currency, C, and then exchanging currency C into currency B. This occurs when the exchange markets are out of equilibrium or varying markets exist based upon official and non-official exchange rates.

113) Each of the variables in these equations must be estimated so it is unlikely, even unrealistic, to expect them to hold with any high degree of accuracy. In addition, most countries manage the value of their currencies to some extent which adds a significant amount of noise to the exchange rate process. In addition, when it comes to purchasing power parity it is difficult to identify identical goods with equal demands based on geographic differences in products, customs, and preferences.

114) The requirements for absolute PPP to hold are zero trading costs, lack of trade barriers, and identical goods. Absolute PPP would likely hold to some degree for U.S. and Canadian firms sitting on the border directly across from one another, especially with the reduction of trading costs brought about by NAFTA. However, absolute PPP most likely does not hold for the Houston and London firms because of the significant transportation and search costs between these two locations.

115) In the home currency approach, you must forecast both the foreign cash flows and the future expected exchange rates, convert the foreign currency cash flows into dollars, and discount those dollar cash flows at the cost of capital for dollar-denominated investments. In the foreign currency approach, you forecast the foreign cash flows, determine the discount rate appropriate for cash flows denominated in the foreign currency and discount those cash flows to the present. You then convert the NPV to dollars using the current exchange rate. If done properly, both approaches give identical results. However, the foreign currency approach is computationally somewhat more straightforward.