**CHAP 1**

What major dimension sets apart international finance from domestic finance?  
  
A. Foreign exchange and political risks  
B. Market imperfections  
C. Expanded opportunity set  
D. All of the above

D

An example of a political risk is  
  
A. expropriation of assets.  
B. adverse change in tax rules.  
C. the opposition party being elected.  
D. both answers a) and b) are correct.

D

Production of goods and services has become globalized to a large extent as a result of  
  
A. natural resources being depleted in one country after another.  
B.skilled labor being highly mobile.  
C.multinational corporations' efforts to source inputs and locate production anywhere where costs are lower and profits higher.  
D.common tastes worldwide for the same goods and services.

C

Recently, financial markets have become highly integrated. This development  
  
A. allows investors to diversify their portfolios internationally.  
B.allows minority investors to buy and sell stocks.  
C.has increased the cost of capital for firms.  
D.answers a) and c) are both correct.

A

Japan has experienced large trade surpluses. Japanese investors have responded to this by  
  
A. liquidating their positions in stocks to buy dollar denominated bonds.  
B. investing heavily in U.S. and other foreign financial markets.  
C. lobbying the U.S. government to depreciate its currency  
D. lobbying the Japanese government to allow the yen to appreciate.

B

Suppose your firm invests $100,000 in a project in Italy. At the time the exchange rate is $1.25 = €1.00. One year later the exchange rate is the same, but the Italian government has expropriated your firm's assets paying only €80,000 in compensation. This is an example of  
  
A. exchange rate risk.  
B. political risk.  
C. market imperfections.  
D. none of the above, since $100,000 = €80,000 $1.25/€1.00

B

Suppose you start with $100 and buy stock for £50 when the exchange rate is £1 = $2. One year later, the stock rises to £60. You are happy with your 20 percent return on the stock, but when you sell the stock and exchange your £60 for dollars, you only get $45 since the pound has fallen to £1 = $0.75. This loss of value is an example of  
  
A. exchange rate risk.  
B. political risk.  
C. market imperfections.  
D. weakness in the dollar.

B

Suppose that Great Britain is a major export market for your firm, a U.S.-based MNC. If the British pound depreciates against the U.S. dollar,  
  
A. your firm will be able to charge more in dollar terms while keeping pound prices stable.  
B. your firm may be priced out of the U.K. market, to the extent that your dollar costs stay constant and your pound prices will rise.  
C. to protect U.K. market share, your firm may have to cut the dollar price of your goods to keep the pound price the same.  
D. both b) and c) are correct

D

Suppose Mexico is a major export market for your U.S.-based company and the Mexican peso appreciates drastically against the U.S. dollar. This means  
  
A. your company's products can be priced out of the Mexican market, as the peso price of American imports will rise following the peso's fall.  
B. your firm will be able to charge more in dollar terms while keeping peso prices stable.  
C. your domestic competitors will enjoy a period of facing lessened price competition from Mexican imports.  
D. both b) and c) are correct

D

Suppose Mexico is a major export market for your U.S.-based company and the Mexican peso depreciates drastically against the U.S. dollar, as it did in December 1994. This means  
  
A. your company's products can be priced out of the Mexican market, as the peso price of American imports will rise following the peso's fall.  
B. your firm will be able to charge more in dollar terms while keeping peso prices stable.  
C. your domestic competitors will enjoy a period of facing little price competition from Mexican imports.  
D. both b) and c) are correct

A

Suppose that you are a U.S. producer of a commodity good competing with foreign producers. Your inputs of production are priced in dollars and you sell your output in dollars. If the U.S. currency depreciates against the currencies of our trading partners,  
  
A. your competitive position is likely improved.  
B. your competitive position is likely worsened.  
C. your competitive position is unchanged.

A

Undoubtedly, we are now living in a world where all the major economic functions—consumption, production, and investment  
  
A. are still inherently local.  
B. are still regional in nature.  
C. are slowly becoming globalized. D. are highly globalized.

D

Most governments at least try to make it difficult for people to cross their borders illegally. This barrier to the free movement of labor is an example of  
  
A. information asymmetry.  
B. excessive transactions costs.  
C. racial discrimination. D. a market imperfection.

D

Although the world economy is much more integrated today than was the case 10 or 20 years ago, a variety of barriers still hamper free movements of people, goods, services, and capital across national boundaries. These barriers include  
  
A. legal restrictions.  
B. excessive transportation costs.  
C. information asymmetry.  
D. all of the above

D

The Japanese automobile company Honda decided to establish production facilities in Ohio, mainly to  
  
A. circumvent trade barriers.  
B. reduce transportation costs.  
C. reduce transactions costs.  
D. both a) and b)

A

When individual investors become aware of overseas investment opportunities and are willing to diversify their portfolios internationally,  
  
A. they trade one market imperfection, information asymmetry, for another, exchange rate risk.  
B. they benefit from an expanded opportunity set.  
C. they should not bother to read or to understand the prospectus, since it's probably written in a foreign language.  
D. they should invest only in dollars or euros.

B

The Nestlé Corporation, a well-known Swiss MNC, used to issue two different classes of common stock, bearer shares and registered shares, and foreigners were allowed to hold only  
  
A. registered shares.  
B. bearer shares.  
C. voting shares.  
D. convertible shares.

B

Deregulated financial markets and heightened competition in financial services provided an environment for financial innovations that resulted in the introduction of various instruments. Examples of these innovative instruments include  
  
A. currency futures and options, foreign stock index futures and options.  
B. multicurrency bonds.  
C. international mutual funds, country funds, exchange traded funds.  
D. all of the above

D

Nestlé, a well-known Swiss corporation,  
  
A. has been a paragon of virtue in its opposition to all forms of political risk.  
B. at one time placed restrictions on foreign ownership of its stock. When it relaxed these restrictions, the total market value of the firm fell.  
C. at one time placed restrictions on foreign ownership of its stock. When it relaxed these restrictions, there was a major transfer of wealth from foreign shareholders to Swiss shareholders.  
D. none of the above

C

The goal of shareholder wealth maximization  
  
A. is not appropriate for non-U.S. business firms.  
B. means that all business decisions and investments that a firm makes are done for the purpose of making the owners of the firm better off financially.  
C. is a sub-objective the firm should attempt to achieve after the objective of customer satisfaction is met.  
D. is in conflict with the privatization process taking place in third-world countries.

B

As capital markets are becoming more integrated, the goal of shareholder wealth maximization  
  
A. has been altered to include other goals as well.  
B. has lost out to other goals, even in the U.S.  
C. has been given increasing importance by managers in Europe.  
D. has been shown to be a deterrent to raising funds abroad.

C

Recent corporate scandals at firms such as Enron, WorldCom and the Italian firm Parmalat  
  
A. show that managers might be tempted to pursue their own private interests at the expense of shareholders.  
B. show that Italian shareholders are better at monitoring managerial behavior than U.S. shareholders.  
C. show that white-collar criminals hardly ever get punished.  
D. show that socialism is a better way to go than capitalism.

A

While the corporate governance problem is not confined to the United States,  
  
A. it can be a much more serious problem in many other parts of the world, where legal protection of shareholders is weak or nonexistent.  
B. it has reached its high point in the United States.  
C. the U.S. legal system, with lawsuits used only as a last resort, ensured that any conflicts of interest will soon be a thing of the past.  
D. none of the above

A

The owners of a business are the  
  
A. taxpayers.  
B. workers.  
C. suppliers.  
D. shareholders.

D

The massive privatization that is currently taking place in formerly socialist countries, will likely  
  
A. eventually enhance the standard of living to these countries' citizens.  
B. depend on private investment.  
C. increase the opportunity set facing these countries' citizens.  
D. all of the above

D

A firm with concentrated ownership  
  
A. may give rise to conflicts of interest between dominant shareholders and small outside shareholders.  
B. may enjoy more accounting transparency than firms with diffuse ownership structures.  
C. is a partnership, never a corporation.  
D. tends to exist overseas but not in the U.S.

D

The ultimate guardians of shareholder interest in a corporation, are the  
  
A. rank and file workers.  
B. senior management.  
C. boards of directors.  
D. all of the above.

C

In countries like France and Germany,  
  
A. managers have often made business decisions with regard to maximizing market share to the exclusion of other goals.  
B. managers have often viewed shareholders as one of the "stakeholders" of the firm, others being employees, customers, suppliers, banks and so forth.  
C. managers have often regarded the prosperity and growth of their combines, or families of related firms, as their critical goal.  
D. managers have traditionally embraced the maximization of shareholder wealth as the only worthy goal.

B

When corporate governance breaks down  
  
A. shareholders are unlikely to receive fair returns on their investments.  
B. managers may be tempted to enrich themselves at shareholder expense.  
C. the board of directors is not doing its job.  
D. all of the above

D

Privatization refers to the process of  
  
A. having government operate businesses for the betterment of the public sector.  
B. government allowing the operation of privately owned business.  
C. prohibiting government operated enterprises.  
D. a country divesting itself of the ownership and operation of a business venture by turning it over to the free market system.

D

Deregulation of world financial markets  
  
A. provided a natural environment for financial innovations, like currency futures and options.  
B. has promoted competition among market participants.  
C. has encouraged developing countries such as Chile, Mexico, and Korea to liberalize by allowing foreigners to directly invest in their financial markets.  
D. all of the above

D

The emergence of global financial markets is due in no small part to  
  
A. advances in computer and telecommunications technology.  
B. enforcement of the Soviet system of state ownership of resources of production.  
C. government regulation and protection of infant industries.  
D. none of the above

A

The common monetary policy for the euro zone is now formulated by  
  
A. the Bundesbank in Germany.  
B. the Federal Reserve Bank.  
C. the World Bank.  
D. the European Central Bank.

D

Since the end of World War I, the dominant global currency has been the  
  
A. British pound.  
B. Japanese yen.  
C. Euro.  
D. U.S. dollar.

D

Since the end of World War I, the U.S. dollar has played the role of the dominant global currency, displacing the  
  
A. German mark.  
B. French Franc.  
C. Japanese Yen.  
D. British pound.

D

The ascendance of the dollar the dominant global currency reflects several key factors such as  
  
A. the size of the U.S. population.  
B. the mature and open capital markets of the U.S. economy.  
C. exchange rate stability.  
D. all of the above.

B

The euro  
  
A. is the common currency of Europe.  
B. is divisible into 100 cents, just like the U.S. dollar.  
C. may eventually have a transaction domain larger than the U.S. dollar.  
D. all of the above.

D

Since its inception the euro has brought about revolutionary changes in European finance. For example,  
  
A. by redenominating corporate bonds and stocks from 12 different currencies into one common currency, the euro has precipitated the emergence of continent wide capital markets in Europe that are comparable to U.S. markets in depth and liquidity.  
B. Swiss bank accounts are all denominated in euro.  
C. the European banking sector has become much more important as a source of financing for European firms.  
D. there have actually not been any revolutionary changes.

A

In David Ricardo's theory of comparative advantage,  
  
A. international trade is a zero-sum game in which one trading partner's gain comes at the expense of another's loss.  
B. liberalization of international trade will enhance the welfare of the world's citizens.  
C. is a short-run argument, not a long-run argument.  
D. has been superseded by the now-orthodox view of mercantilism.

B

Under the theory of comparative advantage, liberalization of international trade will  
  
A. enhance the welfare of the world's citizens.  
B. create unemployment and displacement of workers permanently.  
C. result in higher prices in the long run as monopolists are able to charge higher prices after eliminating their competitors.  
D. all of the above

A

Privatization is often seen as a cure for bureaucratic inefficiency and waste; some economists estimate that privatization improves efficiency and reduces operating costs by as much as  
  
A. 5 percent.  
B. 10 percent.  
C. 15 percent.  
D. 20 percent.

D

Privatization  
  
A. has spurred a tremendous increase in cross-border investment.  
B. has allowed many governments to have the funds to nationalize important industries.  
C. has guaranteed that new ownership will be limited to the local citizens.  
D. has generally decreased the efficiency of the enterprise.

A

The World Trade Organization, WTO,  
  
A. has the power to enforce the rules of international trade.  
B. covers agriculture and physical goods, but not services or intellectual property rights.  
C. recently expelled China for human rights violations.  
D. ruled that NAFTA is to be the model for world trade integration.

A

The theory of comparative advantage  
  
A. claims that economic well-being is enhanced if each country's citizens produce only a single product.  
B. claims that economic well-being is enhanced when all countries compare commodity prices after adjusting for exchange rate differences in order to standardize the prices charged all countries.  
C. claims that economic well-being is enhanced if each country's citizens produce that which they have a comparative advantage in producing relative to the citizens of other countries, and then trade production.  
D. claims that no country has an absolute advantage over another country in the production of any good or service.

C

A multinational firm can be defined as a firm that  
  
A. invests short-term cash inflows in more than one currency.  
B. has sales affiliates in several countries.  
C. is incorporated in more than one country.  
D. incorporated in one country that has production and sales operations in several other countries.

D

An MNC may gain from its global presence by  
  
A. spreading R&D expenditures and advertising costs over their global sales.  
B. pooling global purchasing power over suppliers.  
C. utilizing their technological and managerial know-how globally with minimum additional costs.  
D. all of the above are potential gains

D

MNCs can use their global presence to  
  
A. take advantage of underpriced labor services available in certain developing countries.  
B. gain access to special R&D capabilities residing in advanced foreign counties.  
C. boost profit margins and create shareholder value.  
D. all of the above

D

Foreign-owned manufacturing companies in the world's most highly developed countries  
  
A. generally are more productive and pay their workers more than do comparable locally-owned businesses.  
B. generally are less productive and therefore pay their workers less than do comparable locally-owned businesses.  
C. tend to specialize in different articles of manufacture than they produce in their home countries.  
D. usually do not build their own production facilities but simply buy existing domestic manufacturing firms.

A

A purely domestic firm sources its products, sells its products, and raises its funds domestically  
  
A. can face stiff competition from a multinational corporation that can source its products in one country, sell them in several countries, and raise its funds in a third country.  
B. can be more competitive than an MNC on its home turf due to superior knowledge of the local market.  
C. can still face exchange rate risk, just like an MNC.  
D. all of the above are true

D

MNC stands for  
  
A. Multinational Corporation.  
B. Multi Nationalized Corporation.  
C. Military National Cooperation.

A

Which is growing at a faster rate, foreign direct investment by MNCs or international trade?  
  
A. FDI by MNCs.  
B. International trade.  
C. Since they are linked, they grow at the same rate.  
D. None of the above.

A

A true MNC, with operations in dozens of different countries  
  
A. must effectively manage foreign exchange risk.  
B. can ignore foreign exchange risk since it is diversified. C. will pay taxes in only its home county.  
D. none of the above

A

An MNC can  
  
A. be a factor that increases the opportunities of the citizens of less developed countries.  
B. be a factor that increases the opportunity set of domestic investors.  
C. increase economic efficiency.  
D. all of the above

D

Today for an MNC to produce merchandise in one country on capital equipment financed by funds raised in a number of different currencies through issuing securities to investors in many countries and then selling the finished product to customers in yet other countries is  
  
A. not uncommon.  
B. extremely common.  
C. uncommon.  
D. the norm.

A

A corporation that can source its products in one country, sell them in another country, and raise the funds in a third country  
  
A. is a multinational corporation.  
B. is a domestic firm if all of the shareholders are from the same country.  
C. enjoys a built-in hedge against exchange rate risk.  
D. enjoys a built-in hedge against political risk.

A

Country A can produce 10 yards of textiles or 6 pounds of food per unit of input. Compute the opportunity cost of producing one additional unit of food instead of textiles.  
  
A. 1 yard of textiles per 1.67 pounds of food  
B. 1 pound of food per 1.67 yards of textiles  
C. 1 yard of textiles per .6 pounds of food  
D. 1 pound of food per .6 yards of textiles

C

The gains from trade  
  
A. are likely realized in the long run when workers and firms have had the time to adjust to the new competitive environment.  
B. are immediately realized in the short run, when governments drop protectionist policies.  
C. are smaller than the costs of adjustment.  
D. none of the above

A

Restrictions or impediments to free trade include such things as  
  
A. import quotas.  
B. import tariffs.  
C. costly transportation.  
D. all of the above

D

Suppose that country A is twice as good at producing widgets as country B. If the currency of B is twice as valuable as the currency of A,  
  
A. the comparative advantage will be canceled out.  
B. trade will be an improved outcome for both A and B.  
C. the comparative advantage could possible be canceled out depending on how much it costs to produce the widget in country B.  
D. none of the above

C

Comparative advantage  
  
A. is also known as relative efficiency.  
B. can lead to trade even in the face of absolute efficiency.  
C. exists when one party can produce a good or service at a lower opportunity cost than another party.  
D. all of the above

D

Country A can produce 10 yards of textiles or 6 pounds of food per unit of input. Country B can produce 8 yards of textiles or 5 pounds of food per unit of input.  
  
A. Country A is relatively more efficient than Country B in the production of food.  
B. Country B is relatively more efficient than Country A in the production of textiles.  
C. Country A has an absolute advantage over Country B in the production of food and textiles.  
D. Country B has an absolute advantage over Country A in the production of food and textiles.

C

Underlying the theory of comparative advantage are assumptions regarding  
  
A. free trade between nations.  
B. that the factors of production (land, labor, capital, and entrepreneurial ability) are relatively immobile.  
C. that the factors of production (land, labor, capital, and entrepreneurial ability) are relatively mobile.  
D. a) and b)

D

If one country is twice the size of another country and is better at making almost everything than the benighted citizens of the smaller county,  
  
A. the bigger country enjoys an absolute advantage.  
B. the bigger country enjoys a relative advantage.  
C. the bigger country enjoys a comparative advantage.  
D. there is not enough information to make a determination.

A

Country A can produce 10 yards of textiles or 6 pounds of food per unit of input. Country B can produce 8 yards of textiles or 5 pounds of food per unit of input.  
  
A. Country A is relatively more efficient than Country B in the production of food.  
B. Country B is relatively more efficient than Country A in the production of textiles.  
C. Country A has an absolute advantage over Country B in the production of food and textiles.  
D. Answers b) and c) are both correct

D

Country A can produce 10 yards of textiles or 6 pounds of food per unit of input. Country B can produce 8  
yards of textiles or 5 pounds of food per unit of input.  
  
A. Country A is relatively more efficient than Country B in the production of textiles.  
B. Country B is relatively more efficient than Country A in the production of food.  
C. Country A has an absolute advantage over Country B in the production of food and textiles.  
D. all of the above

D

Consider the no-trade input/output situation presented in the following table and graph for countries A and  
B. Assuming that free trade is legal; develop a scenario that will benefit the citizens of both countries.  
  
A. Country B should make all the textiles and trade with Country A for food.  
B. Country A should make nothing but textiles and trade with Country B for food.  
C. Country B should make all the textiles and Country A should make all the food.  
D. Country B should make nothing but textiles and trade with Country A for food.

B

Countries A and B currently consume 400 units of food and 400 units of textiles each and currently do not  
trade with one another. The citizens of country A have to give up one unit of food to gain two units of textiles,  
while the citizens of country B have to give up one unit of textiles to gain two units of food. Their production  
possibilities curves are shown.  
  
Under the theory of comparative advantage  
A. The citizens of country A should make food and trade with the citizens of country B for textiles.  
B. The citizens of country A should make textiles and trade with the citizens of country B for food.  
C. There are no gains from trade in this example.  
D. A is twice as good as B at making food and B is twice as good as A at making textiles.

B

Counties A and B currently consume 400 units of food and 400 units of textiles each and currently do not  
trade with one another. The citizens of country A have to give up one unit of food to gain two units of textiles,  
while the citizens of country B have to give up one unit of textiles to gain two units of food. Their production  
possibilities curves are shown.  
  
Under the theory of comparative advantage, if free trade is allowed, the market clearing price (or exchange rate  
if you will) between food and textiles will be  
A. one unit of food for one unit of textiles.  
B. somewhere between one unit of food for two units of textiles and two units of food for one unit of textiles.  
C. one unit of food for two units of textiles.  
D. two units of food for one unit of textiles.

B

Countries A and B currently consume 400 units of food and 400 units of textiles each and currently do not  
trade with one another. The citizens of country A have to give up one unit of food to gain two units of textiles,  
while the citizens of country B have to give up one unit of textiles to gain two units of food. Their production  
possibilities curves are shown.  
  
Suppose that trade is allowed and that the international exchange rate between food and textiles is one-for-one.  
The increased consumption following trade will be  
A. an increase of 400 units of food and 400 units of textiles.  
B. an increase of 1,200 units of food and 1,200 units of textiles.  
C. an increase of 800 units of food and 800 units of textiles.  
D. there are no gains from trade in this example.

A

In modern times, it is not a country per se but rather a controller of capital and know-how that gives the  
country in which it is domiciled a comparative advantage over another country. These controllers of capital and  
technology are  
A. the state.  
B. the multinational corporations (MNCs).  
C. portfolio managers of international mutual funds.  
D. none of the above

B

International trade is  
  
A. a "zero-sum" game in which one country benefits at the expense of another country.  
B. an "increasing-sum" game at which all players become winners.  
C. none of the above

B

The doctrine of comparative advantage was first put forth by  
  
A. Adam Smith.  
B. Adam Sandler.  
C. David Ricardo.  
D. Ricky Ricardo.  
E. none of the above

C

The comparative advantage argument in free trade  
  
A. ignores the cost of readjustment.  
B. is a short-run argument.  
C. only works for two goods at a time.  
D. none of the above

A

If you can make a good at a low opportunity cost,  
  
A. you would be well served to produce that good and trade for other goods.  
B. you should make something else that has a higher value. C. you should make something else that has a higher opportunity cost.  
D. none of the above

A

A country like North Korea  
  
A. probably rejects the notion of increased opportunity presented by free trade.  
B. engages in free trade.  
C. lies on a production possibilities curve superior to South Korea, since North Korea protects its domestic  
producers.  
D. none of the above

A

79. Which state has an absolute advantage in producing wheat in Case I?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

A

80. Which state has an absolute advantage in producing beer in Case I?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

B

Which state has an absolute advantage in producing beer in Case II?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

A

82. Which state has a comparative advantage in producing wine in Case II?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

A

83. Which state has a comparative advantage in wheat production in Case I?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

A

84. Which state has a comparative advantage in wheat production in Case II?  
  
A. South Dakota  
B. North Dakota  
C. Neither state

A

85. What is the relative price of wheat in North Dakota prior to trade in Case II?  
  
A. 2 bushels of wheat = ½ bottle of beer  
B. ½ bushel of wheat = 2 bottles of beer  
C. 1 bushel of wheat = ½ bottle of beer  
D. 1 bushel of wheat = 2 bottles of beer

D

86. For case II, in what range must the "international" price of wheat fall? i.e. if North and South Dakota trade  
only with each other, what is the range of prices possible?  
  
A. Between 1 bushel of wheat = 4/3 bottles of beer and 1 bushel of wheat = 2 bottles of beer  
B. Between 1 bushel of wheat = 3/4 bottles of beer and 1 bushel of wheat = 2 bottles of beer  
C. Between 1 bushel of wheat = 3/4 bottles of beer and 1 bushel of wheat = ½ bottles of beer  
D. None of the above

A

87. For case II, let the international price be 1 bottle = 1 bushel. Derive South Dakota's "trading possibilities  
curve."  
  
A. Option a  
B. Option b  
C. Option c  
D. Option d

C

88. For case II, let the international price be 1 bottle = 1 bushel. Derive North Dakota's "trading possibilities  
curve."  
  
A. Option a  
B. Option b  
C. Option c  
D. Option d

D

89. What is the price of beer without trade in Southern Ireland?  
  
A. 2 bottles of whiskey = 3 kegs of beer  
B. 5 bottles of whiskey = 12 kegs of beer  
C. 1 bottle of whiskey = 1 keg of beer

A

90. What is the price of beer without trade in Northern Ireland?  
  
A. 2 bottles of whiskey = 3 kegs of beer  
B. 5 bottles of whiskey = 12 kegs of beer  
C. 3 bottles of whiskey = 1 keg of beer

C

91. In which product does Northern Ireland have a comparative advantage?  
  
A. Beer  
B. Whiskey  
C. Neither

C

92. Suppose that trade occurs. Each country completely specializes and 500 kegs of beer are traded for 500 bottles of whiskey. What is the international price of beer?  
  
A. 1 bottle of whiskey = 1 keg of beer  
B. 3 bottles of whiskey = 1 keg of beer  
C. 2/3 bottle of whiskey = 1 keg of beer  
D. 1 bottle of whiskey = 3 kegs of beer

A

93. If the international price of beer is one keg of beer = 1 bottle of whiskey, how much whiskey will Northern Ireland consume? Each country completely specializes and 500 kegs of beer are traded for 500 bottles of whiskey.  
  
A. 1,000 bottles  
B. 1,200 bottles  
C. 500 bottles  
D. 600 bottles

A

94. What is the increased amount of goods available in Northern Ireland after trade?  
  
A. 400 more bottles of whiskey and 200 more kegs of beer  
B. 1,000 more bottles of whiskey and 500 more kegs of beer  
C. 200 more bottles of whiskey and 400 more kegs of beer

A

95. Suppose that Northern Ireland and Southern Ireland each have 1,000 hours of labor per day. Southern workers are paid €1 per day and Northern workers are paid £1 per day. What is the exchange rate associated with an international price of one keg of beer = 1 bottle of whiskey?  
  
A. €1.25 = £1  
B. €0.80 = £1  
C. €1 = £1  
D. None of the above

A

96. Consider a dentist and a 14-year old boy. The dentist can make $100 per hour drilling teeth and the 14-year old boy can make $2 per hour picking up used aluminum cans. The dentist is a manly man and can mow his half-acre lot in one hour. The 14-year old boy can mow the lawn in two hours. If the dentist hires the boy to mow his lawn at any price less than $100, but more than $4  
  
A. both he and the boy are better off.  
B. the dentist would be exploiting the boy.  
C. the boy would be exploiting the dentist.  
D. all of the above

A

Consider the no-trade input/output situation presented in the following table and graph for South and North Carolina. Assume that free trade is legal.  
  
97. Which state is better at making guns?  
A. South Carolina  
B. North Carolina  
C. neither

A

98. Suppose that the citizens of North and South Carolina are currently consuming as much butter as they care to. What is the maximum increase in the number of guns that could occur following trade?  
  
A. 83.33 guns  
B. 533.33 guns  
C. No increase

A

99. What is the relative price of a gun in terms of butter in South Carolina?  
  
A. 1 gun costs 3 butters  
B. 3 guns cost 1 butter  
C. 1 gun costs 2 butters  
D. 2 gun costs 1 butter

C

100. What is the relative price of a gun in terms of butter in North Carolina?  
  
A. 1 gun costs 3 butters  
B. 3 guns cost 1 butter  
C. 1 gun costs 2 butters  
D. 2 gun costs 1 butter

A

**CHAP 2**

The international monetary system can be defined as the institutional framework within which  
  
  
A. international payments are made.  
  
B. movement of capital is accommodated.  
  
C. exchange rates among currencies are determined.  
  
D. all of the above

D. all of the above

Corporations today are operating in an environment in which exchange rate changes may adversely affect their competitive positions in the marketplace. This situation, in turn, makes it necessary for many firms to  
  
  
A. carefully manage their exchange risk exposure.  
  
B. carefully measure their exchange risk exposure.  
  
C. both a and b

C. both a and b

The international monetary system went through several distinct stages of evolution. These stages are summarized, in alphabetic order, as follows:  
  
(i) - Bimetallism  
(ii) - Bretton Woods system  
(iii) - Classical gold standard  
(iv) - Flexible exchange rate regime  
(v) - Interwar period  
  
The chronological order that they actually occurred is:  
  
  
A. (iii), (i), (iv), (ii), and (v)  
  
B. (i), (iii), (v), (ii), and (iv)  
  
C. (vi), (i), (iii), (ii), and (v)  
  
D. (v), (ii), (i), (iii), and (iv)

B. (i), (iii), (v), (ii), and (iv)

In the United States, bimetallism was adopted by the Coinage Act of 1792 and remained a legal standard until 1873,  
  
  
A. when Congress dropped the silver dollar from the list of coins to be minted.  
  
B. when Congress dropped the twenty-dollar gold piece from the list of coins to be minted.  
  
C. when gold from the California gold rush drove silver out of circulation.  
  
D. when gold from the California gold rush drove gold out of circulation.

A. when Congress dropped the silver dollar from the list of coins to be minted.

The monetary system of bimetallism is unstable. Due to the fluctuation of the commercial value of the metals,  
  
  
A. the metal with a commercial value lower than the currency value tends to be used as metal and is withdrawn from circulation as money (Gresham's Law).  
  
B. the metal with a commercial value higher than the currency value tends to be used as money (Gresham's Law).  
  
C. the metal with a commercial value higher than the currency value tends to be used as metal and is withdrawn from circulation as money (Gresham's Law).  
  
D. none of the above

C. the metal with a commercial value higher than the currency value tends to be used as metal and is withdrawn from circulation as money (Gresham's Law).

In the 1850s the French franc was valued by both gold and silver, under the official French ratio which equated a gold franc to a silver franc 15½ times as heavy. At the same time, the gold from newly discovered mines in California poured into the market, depressing the value of gold. As a result,  
  
  
A. the franc effectively became a silver currency.  
  
B. the franc effectively became a gold currency.  
  
C. silver became overvalued under the French official ratio.  
  
D. answers a and c are correct

B. the franc effectively became a gold currency.

Gresham's Law states that  
  
  
A. bad money drives good money out of circulation.  
  
B. good money drives bad money out of circulation.  
  
C. if a country bases its currency on both gold and silver, at an official exchange rate, it will be the more valuable of the two metals that circulate.  
  
D. none of the above.

A. bad money drives good money out of circulation.

Suppose that the pound is pegged to gold at £20 per ounce and the dollar is pegged to gold at $35 per ounce. This implies an exchange rate of $1.75 per pound. If the current market exchange rate is $1.80 per pound, how would you take advantage of this situation? Hint: assume that you have $350 available for investment.  
  
  
A. Start with $350. Buy 10 ounces of gold with dollars at $35 per ounce. Convert the gold to £200 at £20 per ounce. Exchange the £200 for dollars at the current rate of $1.80 per pound to get $360.  
  
B. Start with $350. Exchange the dollars for pounds at the current rate of $1.80 per pound. Buy gold with pounds at £20 per ounce. Convert the gold to dollars at $35 per ounce.  
  
C. a and b both work  
  
D. None of the above

A. Start with $350. Buy 10 ounces of gold with dollars at $35 per ounce. Convert the gold to £200 at £20 per ounce. Exchange the £200 for dollars at the current rate of $1.80 per pound to get $360.

Suppose that the United States is on a bimetallic standard at $30 to one ounce of gold and $2 for one ounce of silver. If new silver mines open and flood the market with silver,  
  
  
A. only the silver currency will circulate.  
  
B. only the gold currency will circulate.  
  
C. no change will take place since citizens could exchange their gold currency for silver currency at any time.  
  
D. none of the above

A. only the silver currency will circulate.

Suppose that your country officially defines gold as ten times more valuable than silver (i.e. the central bank stands ready to redeem the currency in gold and silver and the official price of gold is ten times the official price of silver). If the market price of gold is only eight times as much as silver.  
  
  
A. The central bank could go broke if enough arbitrageurs attempt to take advantage of the pricing disparity.  
  
B. The central bank will make money since they are overpricing gold.

A. The central bank could go broke if enough arbitrageurs attempt to take advantage of the pricing disparity.

Prior to the 1870s, both gold and silver were used as international means of payment and the exchange rates among currencies were determined by either their gold or silver contents. Suppose that the dollar was pegged to gold at $30 per ounce, the French franc is pegged to gold at 90 francs per ounce and to silver at 9 francs per ounce of silver, and the German mark pegged to silver at 1 mark per ounce of silver. What would the exchange rate between the U.S. dollar and German mark be under this system?  
  
  
A. 1 German mark = $2  
  
B. 1 German mark = $0.50  
  
C. 1 German mark = $3  
  
D. 1 German mark = $1

C. 1 German mark = $3

Prior to the 1870s, both gold and silver were used as international means of payment and the exchange rates among currencies were determined by either their gold or silver contents. Suppose that the dollar was pegged to gold at $30 per ounce, the French franc is pegged to gold at 90 francs per ounce and to silver at 6 francs per ounce of silver, and the German mark pegged to silver at 1 mark per ounce of silver. What would the exchange rate between the U.S. dollar and German mark be under this system?  
  
  
A. 1 German mark = $2  
  
B. 1 German mark = $0.50  
  
C. 1 German mark = $3  
  
D. 1 German mark = $1

A. 1 German mark = $2

Suppose that country A and country B are both on a bimetallic standard. In country A the ratio is 15 to one (i.e. an ounce of gold is worth 15 times as much as an ounce of silver in that currency), while in country B the ratio is ten to one. If the free flow of capital is allowed between countries A and B is this a sustainable framework?  
  
  
A. Yes  
  
B. No  
  
C. There is not enough information to make an informed determination.

B. No

The United States adopted the gold standard in  
  
  
A. 1776.  
  
B. 1879.  
  
C. 1864.  
  
D. 1973.

B. 1879.

The gold standard still has ardent supporters who believe that it provides  
  
  
A. an effective hedge against price inflation.  
  
B. fixed exchange rates between all currencies.  
  
C. monetary policy autonomy.  
  
D. all of the above

A. an effective hedge against price inflation.

One potential drawback of the gold standard is that  
  
  
A. the world economy can be subject to deflationary pressure due to the limited supply of monetary gold.  
  
B. the world economy can be subject to inflationary pressure without changes in the supply of monetary gold.  
  
C. gold is scarce.  
  
D. all of the above

A. the world economy can be subject to deflationary pressure due to the limited supply of monetary gold.

The first full-fledged gold standard  
  
  
A. was not established until 1821 in Great Britain, when notes from the Bank of England were made fully redeemable for gold.  
  
B. was not established until 1780 in the United States, when notes from the Continental Army were made fully redeemable for gold.  
  
C. was established in 986 during the Han dynasty in China.  
  
D. none of the above

A. was not established until 1821 in Great Britain, when notes from the Bank of England were made fully redeemable for gold.

An "international" gold standard can be said to exist when  
  
  
A. gold alone is assured of unrestricted coinage.  
  
B. there is two-way convertibility between gold and national currencies at stable ratios.  
  
C. gold may be freely exported or imported.  
  
D. all of the above

D. all of the above

Under a gold standard, if Britain exported more to France than France exported to Great Britain,  
  
  
A. such international imbalances of payment will be corrected automatically.  
  
B. this type of imbalance will not be able to persist indefinitely.  
  
C. net export from Britain will be accompanied by a net flow of gold in the opposite direction.  
  
D. all of the above

D. all of the above

Suppose that Britain pegs the pound to gold at six pounds per ounce, whereas the exchange rate between pounds and U.S. dollars is $5 = £1. What should an ounce of gold be worth in U.S. dollars?  
  
  
A. $29.40  
  
B. $30.00  
  
C. $0.83  
  
D. $1.20

B. $30.00

During the period of the classical gold standard (1875-1914) there were  
  
  
A. highly volatile exchange rates.  
  
B. volatile exchange rates.  
  
C. moderately volatile exchange rates.  
  
D. stable exchange rates.  
  
E. no exchange rates.

D. stable exchange rates.

The majority of countries got off the gold standard in 1914 when  
  
  
A. the American Civil War ended.  
  
B. World War I broke out.  
  
C. World War II started.  
  
D. none of the above

B. World War I broke out.

Suppose that the British pound is pegged to gold at £6 per ounce, whereas one ounce of gold is worth €12. Under the gold standard, any misalignment of the exchange rate will be automatically corrected by cross border flows of gold. Calculate the possible gains for buying €1,000, if the British pound becomes undervalued and trades for €1.80. (Assume zero shipping costs).  
(Hint: Gold is first purchased using the devalued British pound from the Bank of England, then shipped to France and sold for €1,000 to the Bank of France).  
  
  
A. £55.56  
  
B. £65.56  
  
C. £75.56  
  
D. £85.56

A. £55.56

Assume that a country is on the gold standard. In order to support unrestricted convertibility into gold, banknotes need to be backed by a gold reserve of some minimum stated ratio. In addition,  
  
  
A. the domestic money stock should rise and fall as gold flows in and out of the country.  
  
B. the central bank can control the money supply by buying or selling the foreign currencies.  
  
C. Both a and b

A. the domestic money stock should rise and fall as gold flows in and out of the country.

Under the gold standard, international imbalances of payment will be corrected automatically under the  
  
  
A. Gresham Exchange Rate regime.  
  
B. European Monetary System.  
  
C. Price-specie-flow mechanism.  
  
D. Bretton Woods Accord.

C. Price-specie-flow mechanism.

During the period between World War I and World War II,  
  
  
A. the major European powers and the U.S. returned to the gold standard and fixed exchange rates.  
  
B. while most countries abandoned the gold standard during World War I, international trade and investment flourished during the interwar period under a coherent international monetary system.  
  
C. the U.S. dollar emerged as the dominant world currency, gradually replacing the British pound for the role.  
  
D. None of the above.

C. the U.S. dollar emerged as the dominant world currency, gradually replacing the British pound for the role.

During the period between World War I and World War II, many central banks followed a policy of sterilization of gold  
  
  
A. by restricting the rate of growth in the supply of gold.  
  
B. by matching inflows and outflows of gold respectively with reductions and increases in domestic money and credit.  
  
C. by matching inflows and outflows of gold respectively with increases and reductions in domestic money and credit.  
  
D. none of the above.

B. by matching inflows and outflows of gold respectively with reductions and increases in domestic money and credit.

The price-specie-flow mechanism will work only if governments are willing to play by the rules of the game by letting the money stock rise and fall as gold flows in and out. Once the government demonetizes (neutralizes) gold, the mechanism will break down. In addition, the effectiveness of the mechanism depends on  
  
  
A. the income elasticity of the demand for imports.  
  
B. the price elasticity of the demand for imports.  
  
C. the price elasticity of the supply of imports.  
  
D. the income elasticity of the supply of imports.

B. the price elasticity of the demand for imports.

During the period between World War I and World War II, the political reality was characterized by  
  
  
A. halfhearted attempts and failure to restore the gold standard.  
  
B. political instabilities and bank failures.  
  
C. panicky flights of capital across borders.  
  
D. all of the above

C. panicky flights of capital across borders.

At the outbreak of World War I  
  
  
A. major countries such as Great Britain, France, Germany and Russia suspended redemption of banknotes in gold.  
  
B. major countries such as Great Britain, France, Germany and Russia imposed embargoes on the export of gold.  
  
C. the classical gold standard was abandoned.  
  
D. all of the above

B. major countries such as Great Britain, France, Germany and Russia imposed embargoes on the export of gold.

The core of the Bretton Woods system was the  
  
  
A. World Bank.  
  
B. IMF.  
  
C. United Nations.  
  
D. Interstate Commerce Commission.

A. World Bank.

The Bretton Woods system was named after  
  
  
A. the treasury secretary of the United States in 1945, Bretton Woods.  
  
B. Bretton Woods, New Hampshire, where the Articles of Agreement of the International Monetary Fund (IMF) were hammered out.  
  
C. none of the above.

B. Bretton Woods, New Hampshire, where the Articles of Agreement of the International Monetary Fund (IMF) were hammered out.

The Bretton Woods agreement resulted in the creation of  
  
  
A. the bancor as an international reserve asset.  
  
B. the World Bank.  
  
C. the Eximbank.  
  
D. the Federal Reserve Bank.

B. the World Bank.

The Triffin paradox  
  
  
A. was first proposed by Professor Robert Triffin.  
  
B. warned that the gold-exchange system of the Bretton Woods agreement was programmed to collapse in the long run.  
  
C. was indeed responsible for the eventual collapse of the dollar-based gold-exchange system in the early 1970s.  
  
D. all of the above are correct

D. all of the above are correct

Under the Bretton Woods system  
  
  
A. there was an explicit set of rules about the conduct of international monetary policies.  
  
B. each country was responsible for maintaining its exchange rate within 1 percent of the adopted par value by buying or selling foreign exchanges as necessary.  
  
C. the U.S. dollar was the only currency that was fully convertible to gold.  
  
D. all of the above

D. all of the above

Under the Bretton Woods system each country established a par value for its currency in relation to the dollar. And the U.S. dollar was pegged to gold at  
  
  
A. $1 per ounce.  
  
B. $35 per ounce.  
  
C. $350 per ounce.  
  
D. $900 per ounce.

B. $35 per ounce.

Under the Bretton Woods system, Each country was responsible for maintaining its exchange rate within ±1 percent of the adopted par value by  
  
  
A. buying or selling foreign exchanges as necessary.  
  
B. buying or selling gold as necessary.  
  
C. expanding or contracting the supply of loanable funds as necessary.  
  
D. increasing or decreasing their money supply as necessary.

A. buying or selling foreign exchanges as necessary.

Under the Bretton Woods system,  
  
  
A. the U.S. dollar was the only currency that was fully convertible to gold; other currencies were not directly convertible to gold.  
  
B. all currencies of member states were fully convertible to gold.  
  
C. all currencies of member states were fully convertible to gold or silver.  
  
D. none of the above.

A. the U.S. dollar was the only currency that was fully convertible to gold; other currencies were not directly convertible to gold.

In 1963, President John Kennedy imposed the Interest Equalization Tax (IET) on U.S. purchases of foreign securities. The IET was designed to  
  
  
A. decrease the cost of foreign borrowing in the U.S. bond market.  
  
B. increase the cost of foreign borrowing in the U.S. bond market.

B. increase the cost of foreign borrowing in the U.S. bond market.

The growth of the Eurodollar market, which is a transnational, unregulated fund market  
  
  
A. was encouraged by U.S. legislation designed to stem the outflow of dollars from the U.S.  
  
B. was discouraged by U.S. legislation designed to stem the outflow of dollars from the U.S.

A. was encouraged by U.S. legislation designed to stem the outflow of dollars from the U.S.

In the years leading to the collapse of the Bretton Woods system  
  
  
A. it became clear that the dollar was undervalued.  
  
B. it became clear that the dollar was overvalued.

B. it became clear that the dollar was overvalued.

Under the Bretton Woods system  
  
  
A. each country established a par value for its currency in relation to the dollar.  
  
B. the U.S. dollar was pegged to gold at $35 per ounce.  
  
C. each country was responsible for maintaining its exchange rate within 1 percent of the adopted par value by buying or selling foreign exchanges as necessary.  
  
D. all of the above

D. all of the above

Special Drawing Rights (SDR) are  
  
  
A. an artificial international reserve allotted to the members of the International Monetary Fund (IMF), who can then use it for transactions among themselves or with the IMF.  
  
B. a "portfolio" of currencies, and its value tends to be more stable than the currencies that it is comprised of.  
  
C. used in addition to gold and foreign exchanges, to make international payments.  
  
D. all of the above

D. all of the above

The Bretton Woods system ended in  
  
  
A. 1945.  
  
B. 1973.  
  
C. 1981.  
  
D. 2001.

B. 1973.

Since the end of the fixed exchange rate system of the Smithsonian agreement  
  
  
A. exchange rates were revalued in the Bretton Woods agreement.  
  
B. exchange rates have been allowed to float.  
  
C. the United States returned to a gold standard.  
  
D. the zone of monetary stability has been limited to the U.S., Canada, and Mexico.

B. exchange rates have been allowed to float.

#### Chưa học (55)

Bạn chưa học các thuật ngữ này!

**Chọn 55**

Suppose that the pound is pegged to gold at £20 per ounce and the dollar is pegged to gold at $35 per ounce. This implies an exchange rate of $1.75 per pound. If the current market exchange rate is $1.60 per pound, how would you take advantage of this situation? Hint: assume that you have $350 available for investment.  
  
  
A. Start with $350. Buy 10 ounces of gold with dollars at $35 per ounce. Convert the gold to £200 at £20 per ounce. Exchange the £200 for dollars at the current rate of $1.80 per pound to get $360.  
  
B. Start with $350. Exchange the dollars for pounds at the current rate of $1.60 per pound. Buy gold with pounds at £20 per ounce. Convert the gold to dollars at $35 per ounce.  
  
C. a and b both work  
  
D. None of the above

B. Start with $350. Exchange the dollars for pounds at the current rate of $1.60 per pound. Buy gold with pounds at £20 per ounce. Convert the gold to dollars at $35 per ounce.

Suppose that both gold and silver are used as international means of payment and the exchange rates among currencies are determined by either their gold or silver contents. Suppose that the dollar was pegged to gold at $20 per ounce, the Japanese yen is pegged to gold at 120,000 yen per ounce and to silver at 8,000 yen per ounce of silver, and the Australian dollar is pegged to silver at $5 per ounce of silver. What would the exchange rate between the U.S. dollar and Australian dollar be under this system?  
  
  
A. $1 U.S. = $1 Australian  
  
B. $1 U.S. = $2 Australian  
  
C. $1 U.S. = $3 Australian  
  
D. None of the above

C. $1 U.S. = $3 Australian

Suppose that Britain pegs the pound to gold at the market price of £6 per ounce, and the United States pegs the dollar to gold at the market price of $36 per ounce. If the official exchange rate between pounds and U.S. dollars is $5 = £1. Which of the following trades is profitable?  
  
  
A. Start with £100 and trade for $500 at the official exchange rate. Redeem the $500 for 13.89 ounces of gold. Trade the gold for £83.33.  
  
B. Start with $100 and buy gold. Sell the gold for £16.67. Sell the pounds at the official exchange rate.  
  
C. Start with £100 and buy gold. Sell the gold for $600.  
  
D. Start with $500 and trade for £100 at the official exchange rate. Redeem the £100 for 16 2/3 ounces of gold. Trade the gold for $600.

D. Start with $500 and trade for £100 at the official exchange rate. Redeem the £100 for 16 2/3 ounces of gold. Trade the gold for $600.

Since the SDR is a "portfolio" of currencies  
  
  
A. its value tends to be more stable than the value of any of the individual currencies included in the SDR.  
  
B. its value tends to be less stable than the value of any of the individual currencies included in the SDR.  
  
C. its value tends to be as stable as the average of the individual currencies included in the SDR.  
  
D. none of the above

A. its value tends to be more stable than the value of any of the individual currencies included in the SDR.

Put the following in correct date order:  
  
  
A. Jamaica Agreement, Bretton Woods Agreement, Smithsonian Agreement.  
  
B. Smithsonian Agreement, Bretton Woods Agreement, Jamaica Agreement.  
  
C. Bretton Woods Agreement, Smithsonian Agreement, Jamaica Agreement.  
  
D. Bretton Woods Agreement, Jamaica Agreement, Smithsonian Agreement.

C. Bretton Woods Agreement, Smithsonian Agreement, Jamaica Agreement.

Put the following in correct date order:  
  
  
A. Jamaica Agreement, Plaza Agreement, Louvre Accord.  
  
B. Plaza Agreement, Jamaica Agreement, Louvre Accord.  
  
C. Louvre Accord, Jamaica Agreement, Plaza Agreement.  
  
D. Jamaica Agreement, Louvre Accord, Plaza Agreement.

A. Jamaica Agreement, Plaza Agreement, Louvre Accord.

The G-7 is composed of  
  
  
A. Canada, France, Japan, Germany, Italy, the U.K., and the United States.  
  
B. Switzerland, France, Japan, Germany, Italy, the U.K., and the United States.  
  
C. Switzerland, France, North Korea, Germany, Italy, the U.K., and the United States.  
  
D. Switzerland, France, Japan, Germany, Canada, the U.K., and the United States.

A. Canada, France, Japan, Germany, Italy, the U.K., and the United States.

Gold was officially abandoned as an international reserve asset  
  
  
A. in the January 1976 Jamaica Agreement.  
  
B. in the 1971 Smithsonian Agreement.  
  
C. in the 1944 Bretton Woods Agreement.  
  
D. none of the above

A. in the January 1976 Jamaica Agreement.

Following the demise of the Bretton Woods system, the IMF  
  
  
A. created a new role for itself, providing loans to countries facing balance-of-payments and exchange rate difficulties.  
  
B. ceased to exists, since the era of fixed exchange rates had ended.  
  
C. became the sole agent responsible for maintaining fixed exchange rates.  
  
D. became the central bank of the United Nations.

A. created a new role for itself, providing loans to countries facing balance-of-payments and exchange rate difficulties.

Under a flexible exchange rate regime, governments can retain monetary policy independence because the external balance will be achieved by  
  
  
A. the exchange rate adjustments.  
  
B. the price-specie flow mechanism.  
  
C. the Triffin paradox.  
  
D. none of the above

A. the exchange rate adjustments.

The choice between the alternative exchange rate regimes (fixed or floating) is likely to involve a trade-off between  
  
  
A. national monetary policy autonomy and international economic integration.  
  
B. exchange rate uncertainty and national policy autonomy.  
  
C. Balance of Payments autonomy and inflation.  
  
D. unemployment and inflation.

A. national monetary policy autonomy and international economic integration.

Under a purely flexible exchange rate system  
  
  
A. supply and demand set the exchange rates.  
  
B. governments can set the exchange rate by buying or selling reserves.  
  
C. governments can set exchange rates with fiscal policy.  
  
D. answers b and c are correct.

A. supply and demand set the exchange rates.

A currency board arrangement is  
  
  
A. when the currency of another country circulates as the sole legal tender.  
  
B. when the country belongs to a monetary or currency union in which the same legal tender is shared by the members of the union.  
  
C. a monetary regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfillment of its legal obligation.  
  
D. where the country pegs its currency at a fixed rate to a major currency where the exchange rate fluctuates within a narrow margin of less than one percent.

C. a monetary regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfillment of its legal obligation.

Ecuador does not have its own national currency, circulating the U.S. dollar instead. About how many countries do not have their own national currency?  
  
  
A. 10  
  
B. 20  
  
C. 30  
  
D. 40

C. 30

With regard to the current exchange rate arrangement between the U.S. and the U.K., it is best characterized as  
  
  
A. independent floating (market determined).  
  
B. managed float.  
  
C. currency board.  
  
D. pegged exchange rate within a horizontal band.

A. independent floating (market determined).

With regard to the current exchange rate arrangement between Italy and Germany, it is best characterized as  
  
  
A. independent floating (market determined).  
  
B. managed float.  
  
C. an exchange arrangement with no separate legal tender.  
  
D. pegged exchange rate within a horizontal band.

C. an exchange arrangement with no separate legal tender.

On January 1, 1999, an epochal event took place in the arena of international finance when  
  
  
A. all EU countries adopted a common currency called the euro.  
  
B. eight of 15 EU countries adopted a common currency called the euro.  
  
C. nine of 15 EU countries adopted a common currency called the euro.  
  
D. eleven of 15 EU countries adopted a common currency called the euro.

D. eleven of 15 EU countries adopted a common currency called the euro.

The advent of the euro marks the first time that sovereign countries have voluntarily given up their  
  
  
A. national borders to foster economic integration.  
  
B. monetary independence to foster economic integration.  
  
C. fiscal policy independence to foster economic integration.  
  
D. national debt to foster economic integration.

B. monetary independence to foster economic integration.

To pave the way for the European Monetary Union, the member countries of the European Monetary System agreed to achieve a convergence of their economies. Which of the following is NOT a condition of convergence:  
  
  
A. keep the ratio of government budget deficits to GDP below 3 percent.  
  
B. keep gross public debts below 60 percent of GDP.  
  
C. achieve a high degree of price stability.  
  
D. maintain its currency at a fixed exchange rate to the ERM.

D. maintain its currency at a fixed exchange rate to the ERM.

The European Monetary System (EMS) has the chief objective(s)  
  
  
A. to establish a "zone of monetary stability" in Europe.  
  
B. to coordinate exchange rate policies vis-à-vis the non-EMS currencies.  
  
C. to pave the way for the eventual European monetary union.  
  
D. all of the above

D. all of the above

The Exchange Rate Mechanism (ERM) is  
  
  
A. the procedure by which ERM member countries collectively manage their exchange rates.  
  
B. based on a "parity-grid" system, which is a system of par values among ERM countries.  
  
C. a and b  
  
D. none of the above

C. a and b

The Maastricht Treaty  
  
  
A. irrevocably fixed exchange rates among the member currencies.  
  
B. commits the members of the European Union to political union as well as monetary union.  
  
C. was signed and subsequently ratified by the 12 member states.  
  
D. all of the above

D. all of the above

The single European currency, the euro, was adopted by 11 member nations on January 1 of what year?  
  
  
A. 1984  
  
B. 1991  
  
C. 1999  
  
D. 2001

C. 1999

Benefits from adopting a common European currency include  
  
  
A. reduced transaction costs.  
  
B. elimination of exchange rate risk.  
  
C. increased price transparency will promote Europe-wide competition.  
  
D. all of the above

D. all of the above

Monetary policy for the countries using the euro as a currency is now conducted by  
  
  
A. the Federal Reserve.  
  
B. the Bundesbank.  
  
C. European Central Bank.  
  
D. none of the above

C. European Central Bank.

Following the introduction of the euro, the national central banks of the euro-12 nations  
  
  
A. disbanded.  
  
B. formed the ESCB, which is analogous to the Federal Reserve System in the U.S.  
  
C. continue to perform important functions in their jurisdictions.  
  
D. b and c are correct

D. b and c are correct

The main cost of European monetary union is  
  
  
A. the loss of national monetary and exchange rate policy independence.  
  
B. increased exchange rate uncertainty.  
  
C. lessened political integration.  
  
D. none of the above

A. the loss of national monetary and exchange rate policy independence.

The euro zone remarkably comparable to the United States in terms of  
  
  
A. population size.  
  
B. GDP.  
  
C. international trade share.  
  
D. all of the above

A. population size.

Which country is NOT using the euro?  
  
  
A. Greece  
  
B. Italy  
  
C. Sweden  
  
D. Portugal

C. Sweden

Once the changeover to the euro was completed by July 1, 2002, the legal-tender status of national currencies in the euro zone  
  
  
A. was canceled, leaving the euro as the sole legal tender in the euro zone countries.  
  
B. was affirmed at the fixed exchange rate.  
  
C. was tied to gold.  
  
D. none of the above

A. was canceled, leaving the euro as the sole legal tender in the euro zone countries.

According to the theory of optimum currency areas,  
  
  
A. the relevant criterion for identifying and designing a common currency zone is the degree of factor (i.e. capital and labor) mobility within the zone.  
  
B. exchange rates should reflect the degree to which workers are willing to move to get a better job.  
  
C. exchange rates are determined by portfolio managers seeking the highest return.  
  
D. none of the above.

A. the relevant criterion for identifying and designing a common currency zone is the degree of factor (i.e. capital and labor) mobility within the zone.

Willem Duisenberg, the first president of the European Central Bank, defined "price stability" as an annual inflation rate of  
  
  
A. "no more than five percent."  
  
B. "less than but close to 2 percent."  
  
C. "absolutely no more than zero percent."  
  
D. "no more than three percent."

B. "less than but close to 2 percent."

Robert A. Mundell won the Nobel Memorial Prize in Economic Science. He was  
  
  
A. one of the intellectual fathers of both the new European common currency and Reagan-era supply-side economics.  
  
B. one of the intellectual fathers of both the new European common currency and Reagan-era Keynesian economics.  
  
C. one of the intellectual fathers of both the Bretton Woods currency agreement and Keynesian economics.  
  
D. none of the above

B. one of the intellectual fathers of both the new European common currency and Reagan-era Keynesian economics.

In the EU, there is a  
  
  
A. low degree of fiscal integration among EU countries.  
  
B. high degree of fiscal integration among EU countries.

A. low degree of fiscal integration among EU countries.

When money can move freely across borders, policy makers must choose between  
  
  
A. exchange-rate stability and an economic growth.  
  
B. exchange-rate stability and inflation.  
  
C. exchange-rate stability and an independent monetary policy.  
  
D. exchange-rate stability and capital controls.

C. exchange-rate stability and an independent monetary policy.

The Mexican Peso Crisis was touched off by  
  
  
A. an unsurprising announcement by the Mexican government to devalue to peso against the dollar by 14 percent.  
  
B. an unexpected announcement by the Mexican government to devalue to peso against the dollar by 14 percent.  
  
C. an announcement by the Mexican government to enact a currency board arrangement with the U.S. dollar.  
  
D. contagion from other Latin American and Asian financial markets.

B. an unexpected announcement by the Mexican government to devalue to peso against the dollar by 14 percent.

Prior to the peso crisis, Mexico depended on foreign portfolio capital to finance its economic development. This foreign capital influx  
  
  
A. caused higher domestic inflation.  
  
B. led to an overvalued peso.  
  
C. helped Mexico's trade balances.  
  
D. a and b are correct

D. a and b are correct

The Mexican peso crisis is significant in that  
  
  
A. it is perhaps the first serious international financial crisis touched off by cross-border flight of portfolio capital.  
  
B. selling by international portfolio managers had a highly destabilizing, contagious effect on the world financial system.  
  
C. it provides a cautionary tale that as the world's financial markets are becoming more integrated, this type of contagious financial crisis is likely to occur more often.  
  
D. all of the above.

D. all of the above.

The Asian Currency Crisis  
  
  
A. happened just prior to the Mexican peso crisis.  
  
B. turned out to be far more serious than the Mexican peso crisis in terms of the extent of contagion.  
  
C. was limited to Asian currencies.  
  
D. was almost over before anyone outside the pacific rim noticed.

B. turned out to be far more serious than the Mexican peso crisis in terms of the extent of contagion.

Generally speaking, liberalization of financial markets when combined with a weak, underdeveloped domestic financial system tends to  
  
  
A. strengthen the domestic financial system in the short run.  
  
B. create an environment susceptible to currency and financial crises.  
  
C. raise interest rates and lead to domestic recession.  
  
D. none of the above

B. create an environment susceptible to currency and financial crises.

According to the "Trilemma" a country can attain only two of the following three conditions: 1) A fixed exchange rate, (2) Free international flows of capital, (3) An independent monetary policy. This difficulty is also known as  
  
  
A. the incompatible trinity.  
  
B. the Trilemma.  
  
C. the Tobin tax.  
  
D. all three can be had at the same time.

A. the incompatible trinity.

Another name for the incompatible trinity is the  
  
  
A. Tobin Tax.  
  
B. Triffin Paradox.  
  
C. Trilemma.  
  
D. None of the above

B. Triffin Paradox.

To avoid currency crisis in the face of fully integrated capital markets, a country can have a  
  
  
A. floating exchange rate.  
  
B. fixed exchange rate.  
  
C. fixed exchange rate that adjusts.  
  
D. a and b can both help to avoid currency crises.

D. a and b can both help to avoid currency crises.

During the 1990s there  
  
  
A. were three major currency crises.  
  
B. were two major currency crises.  
  
C. was only one currency crisis.  
  
D. were no major currency crises

A. were three major currency crises.

Which factors are related to the collapse of the Argentine currency board system and ensuing economic crisis?  
  
  
A. The lack of fiscal discipline on the part of the Argentine government  
  
B. Labor market inflexibility  
  
C. Contagion from the financial crises in Russia and Brazil  
  
D. All of the above

D. All of the above

Prior to the Argentine Peso Crisis  
  
  
A. Argentina had a "dirty float" where the government allowed the exchange rate to float within wide bands.  
  
B. Argentina had a currency board arrangement with the peso pegged to the U.S. dollar at parity.  
  
C. the Argentine government defaulted on its international debts.  
  
D. weakening of the U.S. dollar led the Argentine government to abandon dollarization.

D. weakening of the U.S. dollar led the Argentine government to abandon dollarization.

A "good" (or ideal) international monetary system should provide  
  
  
A. liquidity, elasticity, and flexibility.  
  
B. elasticity, sensitivity, and reliability.  
  
C. liquidity, adjustments, and confidence.  
  
D. none of the above

C. liquidity, adjustments, and confidence.

A central bank can fix an exchange rate  
  
  
A. in perpetuity.  
  
B. only for as long as the market believes that it has the political will to do so.  
  
C. only for as long as it has reserves of gold.  
  
D. only for as long as it has independence of monetary policy.

B. only for as long as the market believes that it has the political will to do so.

A booming economy with a fixed or stable nominal exchange rate  
  
  
A. inevitably brings about an appreciation of the real exchange rate.  
  
B. inevitably brings about a depreciation of the real exchange rate.  
  
C. inevitably brings about a stabilization of the real exchange rate.  
  
D. inevitably brings about increased volatility of the real exchange rate.

A. inevitably brings about an appreciation of the real exchange rate.

Advantages of a flexible exchange rates include which of the following?  
  
  
A. National policy autonomy.  
  
B. Easier external adjustments.  
  
C. The government can use monetary and fiscal policies to pursue whatever economic goals it chooses.  
  
D. All of the above

D. All of the above

Advantages of a fixed exchange rates include  
  
  
A. reduction in exchange rate risk for businesses.  
  
B. reduction in transactions costs.  
  
C. reduction in trading frictions.  
  
D. all of the above

D. all of the above

Generally speaking, a country would be more prone to asymmetric shocks  
  
  
A. the more diversified and less trade-dependent its economy is.  
  
B. the less diversified and more trade-dependent its economy is.  
  
C. the less diversified and less trade-dependent its economy is.  
  
D. the more diversified and more trade-dependent its economy is.

B. the less diversified and more trade-dependent its economy is.

Once capital markets are integrated, it is difficult for a country to maintain a fixed exchange rate. Why?  
  
  
A. The market forces may be stronger than the exchange rate intervention that the government can muster.  
  
B. Portfolio managers will not invest in countries with fixed exchange rates.  
  
C. Because of the Tobin Tax.  
  
D. None of the above

A. The market forces may be stronger than the exchange rate intervention that the government can muster.

99. Consider the supply-demand framework for the British pound relative to the U.S. dollar shown in the nearby chart. The exchange rate is currently $1.80 = £1.00. Which of the following is correct?  
  
  
  
  
A. At an exchange rate of $1.80 = £1.00, demand for British pounds exceeds supply.  
  
B. At an exchange rate of $1.80 = £1.00, supply for British pounds exceeds demand.  
  
C. Under a flexible exchange rate regime, the U.S. dollar will depreciate to an exchange rate of $1.90 = £1.00.  
  
D. a and c are correct

D. a and c are correct

100. Consider the supply-demand framework for the British pound relative to the U.S. dollar shown in the nearby chart. The exchange rate is currently $1.80 = £1.00. Which of the following is correct?  
  
  
  
  
A. To "fix" the exchange rate at $1.80 = £1.00, the Federal Reserve could use contractionary monetary policy to shift the demand curve to the left.  
  
B. To "fix" the exchange rate at $1.80 = £1.00, the U.S. government could use contractionary fiscal policy to shift the demand curve to the left.  
  
C. The British Government could use fiscal or monetary policy to shift the supply curve to the right to fix the exchange rate to $1.80 = £1.00.  
  
D. All of the above.

D. All of the above.

**CHAP 3**

 Over half of all dollar bills in circulation are held outside American's borders.

True

The current account balance, which is the difference between a country's exports and imports, is a component of the country's GNP. Other components of GNP include  
  
  
A. consumption and investment and government expenditure.  
  
B. consumption and government expenditure and net exports.  
  
C. consumption and net exports and government expenditure.  
  
D. consumption less imports.

A. consumption and investment and government expenditure.

If the United States imports more than it exports, then this means that  
  
  
A. the supply of dollars is likely to exceed the demand in the foreign exchange market, ceteris paribus.  
  
B. the demand for dollars is likely to exceed the supply in the foreign exchange market, ceteris paribus.  
  
C. the U.S. dollar would be under pressure to appreciate against other currencies.  
  
D. both b and c are correct

A. the supply of dollars is likely to exceed the demand in the foreign exchange market, ceteris paribus.

Balance of payments  
  
A. is defined as the statistical record of a country's international transactions over a certain period of time presented in the form of a double-entry bookkeeping.  
  
B. provides detailed information concerning the demand and supply of a country's currency.  
  
C. can be used to evaluate the performance of a country in international economic competition.  
  
D. all of the above

D. all of the above

If a country is grappling with a major balance-of-payment difficulty, it may not be able to expand imports from the outside world. Instead, the country may be tempted to  
  
  
A. impose measures to restrict imports.  
  
B. impose measures to discourage capital outflows.  
  
C. Both a and b  
  
D. None of the above

C. Both a and b

If the United States imports more than it exports, then  
  
  
A. the supply of dollars is likely to exceed the demand in the foreign exchange market, ceteris paribus.  
  
B. one can infer that the U.S. dollar would be under pressure to depreciate against other currencies.  
  
C. a and b  
  
D. None of the above

C. a and b

Generally speaking, any transaction that results in a receipt from foreigners  
  
  
A. will be recorded as a debit, with a negative sign, in the U.S. balance of payments.  
  
B. will be recorded as a debit, with a positive sign, in the U.S. balance of payments.  
  
C. will be recorded as a credit, with a negative sign, in the U.S. balance of payments.  
  
D. will be recorded as a credit, with a positive sign, in the U.S. balance of payments.

D. will be recorded as a credit, with a positive sign, in the U.S. balance of payments.

Generally speaking, any transaction that results in a payment to foreigners  
  
  
A. will be recorded as a debit, with a negative sign, in the U.S. balance of payments.  
  
B. will be recorded as a debit, with a positive sign, in the U.S. balance of payments.  
  
C. will be recorded as a credit, with a negative sign, in the U.S. balance of payments.  
  
D. will be recorded as a credit, with a positive sign, in the U.S. balance of payments.

A. will be recorded as a debit, with a negative sign, in the U.S. balance of payments.

If Japan exports more than it imports, then  
  
  
A. the supply of dollars is likely to exceed the demand in the foreign exchange market, ceteris paribus.  
  
B. one can infer that the yen would be likely to appreciate against other currencies.  
  
C. a and b  
  
D. None of the above

B. one can infer that the yen would be likely to appreciate against other currencies.

The balance of payments records  
  
  
A. only international trade, (exports and imports).  
  
B. only cross-border investments (FDI and portfolio investment).  
  
C. not only international trade, (exports and imports) but also cross-border investments.  
  
D. none of the above

C. not only international trade, (exports and imports) but also cross-border investments.

Credit entries in the U.S. balance of payments  
  
  
A. result from foreign sales of U.S. goods and services, goodwill, financial claims, and real assets.  
  
B. result from U.S. purchases of foreign goods and services, goodwill, financial claims, and real assets.  
  
C. give rise to the demand for dollars.  
  
D. give rise to the supply of dollars.  
  
E. both a and c

E. both a and c

A country experiencing a significant balance-of-payments surplus would be likely to  
  
  
A. expand imports, offering marketing opportunities for foreign enterprises.  
  
B. refrain from imposing foreign exchange restrictions.  
  
C. expand exports, offering international marketing opportunities for domestic enterprises.  
  
D. Both a and b

D. Both a and b



Nâng cấp để gỡ bỏ quảng cáo

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Suppose the McDonalds Corporation imports Canadian beef, paying for it by transferring the funds to a New York bank account kept by the Canadian beef producer.  
  
  
A. Payment by McDonalds will be recorded as a debit.  
  
B. The deposit of the funds by the seller will be recorded as a debit.  
  
C. Payment by McDonalds will be recorded as a credit.  
  
D. The deposit of the funds by the buyer will be credit.

A. Payment by McDonalds will be recorded as a debit.

Since the balance of payments is presented as a system of double-entry bookkeeping,  
  
  
A. every credit in the account is balanced by a matching debit.  
  
B. every debit in the account is balanced by a matching credit.  
  
C. answers a and b are both true  
  
D. none of the above

C. answers a and b are both true

Suppose the InBev Corporation (a non-U.S. MNC) buys the Anheuser-Busch Corporation, paying the U.S. shareholders cash.  
  
  
A. Payment by InBev will be recorded as a debit.  
  
B. The deposit of the funds by the sellers will be recorded as a debit.  
  
C. Payment by InBev will be recorded as a credit.  
  
D. The deposit of the funds by the buyer will be credit.

C. Payment by InBev will be recorded as a credit.

The current account includes  
  
  
A. the export and import of goods and services.  
  
B. all purchases and sales of assets such as stocks, bonds, bank accounts, real estate, and businesses.  
  
C. all purchases and sales of international reserve assets such as dollars, foreign exchanges, gold, and special drawing rights (SDRs).  
  
D. none of the above

A. the export and import of goods and services.

A country with a current account surplus  
  
  
A. acquires IOUs from foreigners, thereby increasing its net foreign wealth.  
  
B. must borrow from foreigners or draw down on its previously accumulated foreign wealth.  
  
C. will experience a reduction in the country's net foreign wealth.  
  
D. both b and c

A. acquires IOUs from foreigners, thereby increasing its net foreign wealth.

The capital account includes  
  
  
A. the export and import of goods and services.  
  
B. all purchases and sales of assets such as stocks, bonds, bank accounts, real estate, and businesses.  
  
C. all purchases and sales of international reserve assets such as dollars, foreign exchanges, gold, and special drawing rights (SDRs).  
  
D. none of the above

B. all purchases and sales of assets such as stocks, bonds, bank accounts, real estate, and businesses.

The official reserve account includes  
  
  
A. the export and import of goods and services.  
  
B. all purchases and sales of assets such as stocks, bonds, bank accounts, real estate, and businesses.  
  
C. all purchases and sales of international reserve assets such as dollars, foreign exchanges, gold, and special drawing rights (SDRs).  
  
D. none of the above

C. all purchases and sales of international reserve assets such as dollars, foreign exchanges, gold, and special drawing rights (SDRs).

A country's international transactions can be grouped into the following three main types:  
  
  
A. current account, medium term account, and long term capital account.  
  
B. current account, long term capital account, and official reserve account.  
  
C. current account, capital account, and official reserve account.  
  
D. capital account, official reserve account, trade account.

C. current account, capital account, and official reserve account.

Invisible trade refers to  
  
  
A. services that avoid tax payments.  
  
B. the underground economy.  
  
C. legal, consulting, and engineering services.  
  
D. tourist expenditures, only.

C. legal, consulting, and engineering services.

A country that gives foreign aid to another country can be viewed as  
  
  
A. importing goodwill from the latter.  
  
B. exporting goodwill to the latter.

A. importing goodwill from the latter.

In 2012 the United States had a current account deficit. The current account deficit implies that the United States  
  
  
A. had a surplus on legal consulting and engineering services.  
  
B. produced more output than it consumed.  
  
C. consumed more output than it produced.  
  
D. none of the above

C. consumed more output than it produced.

The current account is divided into four finer categories:  
  
  
A. merchandise trade, services, factor income, and statistical discrepancy.  
  
B. merchandise trade, services, factor income, and unilateral transfers.  
  
C. merchandise trade, services, portfolio investment, and unilateral transfers.  
  
D. merchandise trade, services, factor income, and direct investment.

B. merchandise trade, services, factor income, and unilateral transfers.

The factors of production are  
  
  
A. land, labor, capital, and entrepreneurial ability.  
  
B. interest, wages and dividends.  
  
C. payments and receipts of interest, dividends, and other income on foreign investments that were previously made.  
  
D. none of the above

A. land, labor, capital, and entrepreneurial ability.

Factor income  
  
  
A. consists largely of interest, dividends, and other income on foreign investments.  
  
B. is a theoretical construct of the factors of production, land, labor, capital, and entrepreneurial ability.  
  
C. is generally a very minor part of national income accounting, smaller than the statistical discrepancy.  
  
D. none of the above

A. consists largely of interest, dividends, and other income on foreign investments.

The entries in the "current account" and the "capital account", combined together, can be outlined (in alphabetic order) as:  
  
(i) - direct investment  
(ii) - factor income  
(iii) - merchandise  
(iv) - official transfer  
(v) - other capital  
(vi) - portfolio investment  
(vii) - private transfer  
(viii) - services  
  
27. Current account includes  
  
  
A. (i), (ii), and (iii)  
  
B. (ii), (iii), and (vii)  
  
C. (iv), (v), and (vii)  
  
D. (i), (v), and (vi)

B. (ii), (iii), and (vii)

The entries in the "current account" and the "capital account", combined together, can be outlined (in alphabetic order) as:  
  
(i) - direct investment  
(ii) - factor income  
(iii) - merchandise  
(iv) - official transfer  
(v) - other capital  
(vi) - portfolio investment  
(vii) - private transfer  
(viii) - services  
  
Capital account includes  
  
  
A. (i), (ii), and (iii)  
  
B. (ii), (iii), and (vii)  
  
C. (iv), (v), and (vii)  
  
D. (i), (v), and (vi)

D. (i), (v), and (vi)

The "J-curve effect" shows  
  
  
A. the initial deterioration and the eventual improvement of a country's trade balance following a currency depreciation.  
  
B. the initial improvement and the eventual depreciation of a country's trade balance following a currency depreciation.  
  
C. the trade balance's lack of responsiveness to the exchanges rate changes.  
  
D. none of the above

A. the initial deterioration and the eventual improvement of a country's trade balance following a currency depreciation.

The "J-curve effect"  
  
  
A. happens most of the time, in the short run.  
  
B. actually only occurs in about 40 percent of the cases according to a study by Sebastian Edwards.  
  
C. is a long-run phenomenon, not a short-run one.  
  
D. none of the above.

B. actually only occurs in about 40 percent of the cases according to a study by Sebastian Edwards.

The J-curve effect received wide attention when  
  
  
A. the British trade balance worsened after a strengthening of the pound in 1967.  
  
B. the British trade balance worsened after a devaluation of the pound in 1967.  
  
C. the British trade balance improved after a devaluation of the pound in 1967.  
  
D. none of the above

B. the British trade balance worsened after a devaluation of the pound in 1967.

A currency depreciation will begin to improve the trade balance immediately  
  
  
A. if the demand for imports and exports are inelastic.  
  
B. if the demand for imports and exports are elastic.  
  
C. if imports decrease and exports decrease.  
  
D. none of the above

B. if the demand for imports and exports are elastic.

When a country's currency depreciates against the currencies of major trading partners,  
  
  
A. the country's exports tend to rise and imports fall.  
  
B. the country's exports tend to fall and imports rise.  
  
C. the country's exports tend to rise and imports rise.  
  
D. the country's exports tend to fall and imports fall.

A. the country's exports tend to rise and imports fall.

A depreciation will begin to improve the trade balance immediately if  
  
  
A. imports and exports are responsive to the exchange rate changes.  
  
B. imports and exports are inelastic to the exchange rate changes.  
  
C. consumers exhibit brand loyalty and price inelasticity.  
  
D. b and c

A. imports and exports are responsive to the exchange rate changes.

In the short run a currency depreciation can make a trade balance worse if  
  
  
A. there is no domestic producer of an import.  
  
B. there is no domestic buyer for an import.  
  
C. there is no export market for a country's output.

A. there is no domestic producer of an import.

What is the correct label for the vertical axis in the J-curve?  
  
  
  
  
A. Time  
  
B. Change in the Trade Balance  
  
C. Size of Trade Balance  
  
D. Size of Merchandise Trade Balance

B. Change in the Trade Balance

In the long run, both exports and imports tend to be  
  
  
A. unresponsive to changes in exchange rates.  
  
B. responsive to changes in exchange rates.  
  
C. both a and b  
  
D. none of the above

B. responsive to changes in exchange rates.

With regard to the capital account  
  
  
A. the capital account balance measures the difference between U.S. sales of assets to foreigners and U.S. purchases of foreign assets.  
  
B. U.S. sales (or exports) of assets are recorded as credits, as they result in capital inflow.  
  
C. U.S. purchases (imports) of foreign assets are recorded as debits, as they lead to capital outflow.  
  
D. all of the above

D. all of the above

The difference between Foreign Direct Investment and Portfolio Investment is that  
  
  
A. Portfolio Investment mostly represents the sale and purchase of foreign financial assets such as stocks and bonds that do not involve a transfer of control.  
  
B. Foreign Direct Investment mostly represents the sale and purchase of foreign financial assets such as stocks whereas Portfolio Investment mostly involves the sales and purchase of foreign bonds.  
  
C. Foreign Direct Investment is about buying land and building factories, whereas portfolio investment is about buying stocks and bonds.  
  
D. All of the above

A. Portfolio Investment mostly represents the sale and purchase of foreign financial assets such as stocks and bonds that do not involve a transfer of control.

In the latter half of the 1980s, with a strong yen, Japanese firms  
  
  
A. faced difficulty exporting.  
  
B. could better afford to acquire U.S. assets that had become less expensive in terms of yen.  
  
C. financed a sharp increase in Japanese FDI in the United States.  
  
D. all of the above

D. all of the above

International portfolio investments have boomed in recent years, as a result of  
  
  
A. a depreciating U.S. dollar.  
  
B. increased gasoline and other commodity prices.  
  
C. the general relaxation of capital controls and regulation in many countries.  
  
D. none of the above

C. the general relaxation of capital controls and regulation in many countries.

If the interest rate rises in the U.S. while other variables remain constant  
  
  
A. capital inflows into the U.S. will increase.  
  
B. capital inflows into the U.S. may not materialize.  
  
C. capital will flow out of the U.S.  
  
D. none of the above

A. capital inflows into the U.S. will increase.

If for a particular county an increase in the interest rate is more or less matched by an expected depreciation in the local currency,  
  
  
A. traders will probably be tempted to find another country to invest in.  
  
B. the interest rate increase per se will not be enough to spark capital flow into the country.  
  
C. both a and b are true  
  
D. capital will glow out of the country as the disgruntled citizens riot and go to war with the neighbors.

C. both a and b are true

The capital account measures  
  
  
A. the sum of U.S. sales of assets to foreigners and U.S. purchases of foreign assets.  
  
B. the difference between U.S. sales of assets to foreigners and U.S. purchases of foreign assets.  
  
C. the difference between U.S. sales of manufactured goods to foreigners and U.S. purchases of foreign products.  
  
D. none of the above

B. the difference between U.S. sales of assets to foreigners and U.S. purchases of foreign assets.

When Honda, a Japanese auto maker, built a factory in Ohio,  
  
  
A. it was engaged in foreign direct investment.  
  
B. it was engaged in portfolio investment.  
  
C. it was engaged in a cross-border acquisition.  
  
D. none of the above.

A. it was engaged in foreign direct investment.

Government controlled investment funds, known as sovereign wealth funds,  
  
  
A. are playing a less-important role in international finance following the end of the fixed exchange rate era.  
  
B. are mostly domiciled in Asian and Middle Eastern countries.  
  
C. are usually are responsible for converting trade surpluses and oil revenues into foreign exchange reserves.  
  
D. none of the above

B. are mostly domiciled in Asian and Middle Eastern countries.

Foreign direct investment (FDI) occurs  
  
  
A. when an investor acquires a measure of control of a foreign business.  
  
B. when there is an acquisition, by a foreign entity in the U.S., of 10 percent or more of the voting shares of a business.  
  
C. with sales and purchases of foreign stocks and bonds that do not involve a transfer of control.  
  
D. both a and b

D. both a and b

The capital account may be divided into three categories:  
  
  
A. cross-border mergers and acquisitions, portfolio investment, and other investment.  
  
B. direct investment, portfolio investment, and Cross-border mergers and acquisitions.  
  
C. direct investment, mergers and acquisitions, and other investment.  
  
D. direct investment, portfolio investment, and other investment.

D. direct investment, portfolio investment, and other investment.

When Nestlé, a Swiss firm, bought the American firm Carnation, it was engaged in foreign direct investment. If Nestlé had only bought a non-controlling number of shares of the firm,  
  
  
A. Nestlé would have been engaged in portfolio investment.  
  
B. Nestlé would have been engaged in a cross-border acquisition.  
  
C. it would depend if they bought the shares from an American or a Canadian.  
  
D. none of the above

A. Nestlé would have been engaged in portfolio investment.

Transactions in currency, bank deposits and so forth  
  
  
A. tend to be insensitive to both changes in relative interest rates and the anticipated change in exchange rate.  
  
B. tend to be sensitive to both changes in relative interest rates and the anticipated change in exchange rate.  
  
C. tend to be sensitive to changes in relative interest rates but insensitive to the anticipated change in exchange rate.  
  
D. tend to be insensitive to changes in relative interest rates but sensitive to the anticipated change in exchange rate.

B. tend to be sensitive to both changes in relative interest rates and the anticipated change in exchange rate.

Since security returns tend to have low correlations among countries,  
  
  
A. investors can reduce risk more effectively if they diversify their portfolio holdings internationally rather than purely domestically.  
  
B. investors who have a domestically diversified portfolio, with exposures across industry types will not gain much from diversifying abroad.  
  
C. investors who diversify internationally will likely underperform investors who keep all their investments in one country.  
  
D. none of the above

A. investors can reduce risk more effectively if they diversify their portfolio holdings internationally rather than purely domestically.

The world's largest debtor nation and creditor nation, respectively, are  
  
  
A. Japan and the U.S.  
  
B. The U.S. and Japan.  
  
C. The U.S. and Canada.  
  
D. Great Britain and Mexico.

B. The U.S. and Japan.

Statistical discrepancy, which by definition represents errors and omissions  
  
  
A. cannot be calculated directly.  
  
B. is calculated by taking into account the balance-of-payments identity.  
  
C. probably has some elements that are honest mistakes, it can't all be money laundering and drugs.  
  
D. all of the above

D. all of the above

The statistical discrepancy in the balance-of-payments accounts  
  
  
A. arise since recordings of payments and receipts are done at different times, in different places, possibly using different methods.  
  
B. arise since some transactions (illegal transactions) occur "off the books".  
  
C. represents omitted and misreported transactions.  
  
D. all of the above

D. all of the above

Which of the following is most indicative of the pressure that a country's currency faces for depreciation or appreciation?  
  
  
A. The current account  
  
B. The capital account  
  
C. The statistical discrepancies  
  
D. The official settlement balance

D. The official settlement balance

The United States is considered  
  
  
A. a net creditor nation.  
  
B. a net debtor nation.

B. a net debtor nation.

Regarding the statistical discrepancy in the balance-of-payments accounts  
  
  
A. there is some evidence that financial transactions may be mainly responsible for the discrepancy.  
  
B. the sum of the balance on the capital account and the statistical discrepancy is very close to the balance of the current account in magnitude.  
  
C. it tends to be positive one year and negative in others, so it's safe to ignore it.  
  
D. a and b

D. a and b

The central bank of the United States is  
  
  
A. the New York Fed.  
  
B. the Federal Reserve System.  
  
C. the EXIM bank.  
  
D. none of the above—the U.S. does not have a central bank.

B. the Federal Reserve System.

When a country must make a net payment to foreigners because of a balance-of-payments deficit, the central bank of the country  
  
  
A. should do nothing.  
  
B. should run down its official reserve assets (e.g. gold, foreign exchanges, and SDRs).  
  
C. should borrow anew from foreign central banks.  
  
D. either b or c will work.

D. either b or c will work.

Continued U.S. trade deficits coupled with foreigners' desire to diversify their currency holdings away from U.S. dollars  
  
  
A. could further diminish the position of the dollar as the dominant reserve currency.  
  
B. could affect the value of U.S. dollar (e.g. through the currency diversification decisions of Asian central banks).  
  
C. could lend steam to the emergence of the euro as a credible reserve currency.  
  
D. all of the above

D. all of the above

Currently, international reserve assets are comprised of  
  
  
A. gold, platinum, foreign exchanges, and special drawing rights (SDRs).  
  
B. gold, foreign exchanges, special drawing rights (SDRs), and reserve positions in the International Monetary Fund (IMF).  
  
C. gold, diamonds, foreign exchanges, and special drawing rights (SDRs).  
  
D. reserve positions in the International Monetary Fund (IMF), only.

B. gold, foreign exchanges, special drawing rights (SDRs), and reserve positions in the International Monetary Fund (IMF).

International reserve assets include "foreign exchanges". These are  
  
  
A. Special Drawing Rights (SDRs) at the IMF.  
  
B. reserve positions in the International Monetary Fund (IMF).  
  
C. foreign currency held by a country's central bank.  
  
D. none of the above

C. foreign currency held by a country's central bank.

The most important international reserve asset, comprising 94 percent of the total reserve assets held by IMF member countries is  
  
  
A. gold.  
  
B. foreign exchanges.  
  
C. special Drawing Rights (SDRs).  
  
D. reserve positions in the International Monetary Fund (IMF).

B. foreign exchanges.

The "one word that haunts the dollar" is  
  
  
A. (Central bank) diversification.  
  
B. Reunification (Korean).  
  
C. Euro.  
  
D. (Current account) deficit.

A. (Central bank) diversification.

The vast majority of the foreign-exchange reserves held by central banks are denominated in  
  
  
A. local currencies.  
  
B. U.S. dollars.  
  
C. Yen.  
  
D. Euro.

B. U.S. dollars.

Among IMF member countries, the dollar's dominant position in the world's reserve holdings may decline to a certain extent as the euro becomes a "known quantity" and its external value becomes more stable. In fact, the euro's share has increased  
  
  
A. from zero percent in 1999 to 25.8 percent in 2006.  
  
B. from 13.5 percent in 1999 to 25.8 percent in 2006.  
  
C. from 13.5 percent in 1999 to 52.8 percent in 2006.  
  
D. none of the above

B. from 13.5 percent in 1999 to 25.8 percent in 2006.

Which of the following would not count as a foreign-exchange reserve held by a central bank?  
  
  
A. The local currency  
  
B. U.S. dollars  
  
C. SDRs  
  
D. Euro

A. The local currency

The balance of payments identity is given by BCA + BKA + BRA = 0. Rearrange the identity for a country with a pure flexible exchange rate regime  
  
  
A. BCA + BKA + BRA = 0  
  
B. BCA = -BKA  
  
C. BCA + BKA = -BRA  
  
D. BRA = -BCA

B. BCA = -BKA

Assume that the balance-of-payments accounts for a country are recorded correctly.  
  
Balance on the current account = BCA = $130 billion  
Balance on the capital account = BKA = -$86 billion  
Balance on the reserves account = BRA = ?  
  
69. The balance on the reserves account (BRA), under the fixed exchange regime is  
  
  
A. -$44 billion  
  
B. $44 billion  
  
C. $216 billion  
  
D. none of the above

A. -$44 billion

Assume that the balance-of-payments accounts for a country are recorded correctly.  
  
Balance on the current account = BCA = $130 billion  
Balance on the capital account = BKA = -$86 billion  
Balance on the reserves account = BRA = ?  
  
The balance on the reserves account (BRA), under the pure flexible exchange regime is  
  
  
A. -$44 billion.  
  
B. $44 billion.  
  
C. $216 billion.  
  
D. none of the above

D. none of the above

In a pure flexible exchange rate regime, a country's central banks will not need to maintain official reserves. Under this regime  
  
  
A. -BCA = BKA.  
  
B. BCA = -BRA = 0.  
  
C. BKA = -BRA.  
  
D. BSA = BCA.

A. -BCA = BKA.

When the balance-of-payments accounts are recorded correctly, the combined balance of the current account, the capital account, and the reserves account must be  
  
  
A. equal in magnitude to the country's national debt.  
  
B. zero.  
  
C. equal in magnitude to the Trade Deficit or Surplus.  
  
D. none of the above

B. zero.

The balance of payments identity is given by BCA + BKA + BRA = 0. Rearrange the identity to solve for the statistical discrepancy.  
  
  
A. The statistical discrepancy = (BCA + BKA) - BRA  
  
B. The statistical discrepancy = BCA - BKA + BRA  
  
C. The statistical discrepancy = BCA - BKA - BRA  
  
D. The statistical discrepancy = BCA + BKA + BRA

D. The statistical discrepancy = BCA + BKA + BRA

BCA stands for  
  
  
A. the balance on the current account.  
  
B. the balance on the capital account.  
  
C. the balance on the official reserves.  
  
D. net imports.

A. the balance on the current account.

BKA stands for  
  
  
A. the balance on the current account.  
  
B. the balance on the capital account.  
  
C. the balance on the official reserves.  
  
D. net imports.

B. the balance on the capital account.

If the central banks of the world chose to diversify their foreign-exchange reserves away from the dollar and into the euro,  
  
  
A. this would have the result of a strengthening of the value of the dollar.  
  
B. this have the result of a weakening in the value of the dollar.  
  
C. this would not have much impact, as the information would be lost in the day-to-day volatility of exchange rates.

B. this have the result of a weakening in the value of the dollar.

The economic theory of mercantilism holds that  
  
  
A. a continuing trade surplus should be a government's major policy goal.  
  
B. the main source of wealth of a country is its productive capacity.  
  
C. free trade is the result of countries exploiting their comparative advantage.  
  
D. none of the above

A. a continuing trade surplus should be a government's major policy goal.

The U.S. Trade Deficit  
  
  
A. is a capital account surplus.  
  
B. is a current account deficit.  
  
C. is both a capital account surplus and a current account deficit.  
  
D. none of the above

C. is both a capital account surplus and a current account deficit.

As of 2011 gold accounted for  
  
  
A. 90 percent of the total reserve assets held by IMF member countries.  
  
B. 70 percent of the total reserve assets held by IMF member countries.  
  
C. approximately 50 percent of the total reserve assets held by IMF member countries.  
  
D. less than one percent of the total reserve assets held by IMF member countries.

D. less than one percent of the total reserve assets held by IMF member countries.

The most popular reserve currency is now the  
  
  
A. U.S. dollar.  
  
B. Euro.  
  
C. Japanese Yen.

A. U.S. dollar.

Suppose a country is currently experiencing a trade deficit. In the long run, this could be self correcting if  
  
  
A. the deficit exists because of the import demand for capital goods.  
  
B. the deficit exists because of the import demand for consumption goods.  
  
C. the deficit exists because foreigners want to buy the country's currency as an investment.  
  
D. none of the above

A. the deficit exists because of the import demand for capital goods.

The capital account is divided into three subcategories: direct investment, portfolio investment, and other investment. Direct investment involves  
  
  
A. acquisitions of controlling interests in foreign businesses.  
  
B. investments in foreign stocks and bonds that do not involve acquisitions of control.  
  
C. bank deposits, currency investment, trade credit, and the like.  
  
D. all of the above

A. acquisitions of controlling interests in foreign businesses.

The capital account is divided into three subcategories: direct investment, portfolio investment, and other investment. Portfolio investment involves  
  
  
A. acquisitions of controlling interests in foreign businesses.  
  
B. investments in foreign stocks and bonds that do not involve acquisitions of control.  
  
C. bank deposits, currency investment, trade credit, and the like.  
  
D. all of the above

B. investments in foreign stocks and bonds that do not involve acquisitions of control.

The capital account is divided into three subcategories: direct investment, portfolio investment, and other investment. "Other" investment involves  
  
  
A. acquisitions of controlling interests in foreign businesses.  
  
B. investments in foreign stocks and bonds that do not involve acquisitions of control.  
  
C. bank deposits, currency investment, trade credit, and the like.  
  
D. all of the above

C. bank deposits, currency investment, trade credit, and the like.

Over the last several years the U.S. has run persistent  
  
  
A. balance-of-payments deficits.  
  
B. balance-of-payments surpluses.  
  
C. current Account deficits.  
  
D. capital Account deficits.

C. current Account deficits.

If a country must make a net payment to foreigners because of a balance-of-payments deficit, the country should  
  
  
A. either increase its official reserve assets or borrow anew from foreigners.  
  
B. either run down its official reserve assets or borrow anew from foreigners.  
  
C. either run down its official reserve assets or lend more foreigners.  
  
D. none of the above

B. either run down its official reserve assets or borrow anew from foreigners.

Under the fixed exchange rate regime  
  
  
A. the combined balance on the current and capital accounts will be equal in size, but opposite in sign, to the change in the official reserves.  
  
B. the balance on the current and capital accounts will be equal in size, but opposite in sign.  
  
C. a current account surplus or deficit must be matched by an official reserves deficit or surplus.  
  
D. a capital account surplus or deficit must be matched by an official reserves deficit or surplus.

A. the combined balance on the current and capital accounts will be equal in size, but opposite in sign, to the change in the official reserves.

Under the pure flexible exchange rate regime  
  
  
A. the combined balance on the current and capital accounts will be equal in size, but opposite in sign, to the change in the official reserves.  
  
B. the balance on the current and capital accounts will be equal in size, but opposite in sign.  
  
C. a current account surplus or deficit must be matched by an official reserves deficit or surplus.  
  
D. a capital account surplus or deficit must be matched by an official reserves deficit or surplus.

B. the balance on the current and capital accounts will be equal in size, but opposite in sign.

More important than he absolute size of a country's balance-of-payments disequilibrium  
  
  
A. is the nature and cause of the disequilibrium.  
  
B. is whether it is a trade surplus or deficit.  
  
C. is whether the local government is mercantilist or not.  
  
D. Nothing is more important than he absolute size of a country's balance-of-payments disequilibrium.

A. is the nature and cause of the disequilibrium.

For question in this section, the notation is  
  
Y = GNP = national income  
C = consumption  
I = private investment  
G = government spending  
X = exports  
M = imports  
  
90. The current account balance is given by  
  
  
A. C + I + G + X + M  
  
B. X - M  
  
C. I + X + M  
  
D. M - X

B. X - M

The difference between a country's savings and investment is given by  
  
  
A. S - I  
  
B. I × S  
  
C. X - M  
  
D. GNP - Y

A. S - I

If the difference between tax revenue and government expenditures is negative, it implies that  
  
  
A. tax revenue is insufficient to cover government spending.  
  
B. a government budget deficit exists.  
  
C. the government will be issuing new debt securities.  
  
D. all of the above

D. all of the above

National income, or Gross National Product is given by  
  
  
A. GNP ≡ Y ≡ C + I + G + X + M  
  
B. GNP ≡ Y ≡ C + I + G + X - M  
  
C. GNP ≡ I ≡ C + Y + G + X - M  
  
D. GNP ≡ Y ≡ C + I + X + M - G

B. GNP ≡ Y ≡ C + I + G + X - M

Which of the following is a true statement?  
  
  
A. BCA ≡ X - M  
  
B. BKA ≡ X - M  
  
C. BKA - BCA ≡ X - M  
  
D. BKA ≡ M - X

A. BCA ≡ X - M

There is an intimate relationship between a country's BCA and how the country finances its domestic investment and pays for government expenditures. This relationship is given by BCA ≡ X - M ≡ (S - I) + (T - G). Given this, which of the following is a true statement?  
  
  
A. If (S - I) < 0, it implies that a country's domestic savings is insufficient to finance domestic investment.  
  
B. If (T - G) < 0, it implies that a country's tax revenue is insufficient to finance government spending.  
  
C. both a and b are true  
  
D. none of the above

C. both a and b are true

There is an intimate relationship between a country's BCA and how the country finances its domestic investment and pays for government expenditures. Given this, which of the following is a true statement?  
  
  
A. If (S - I) < 0, it implies that a country's domestic savings is insufficient to finance domestic investment.  
  
B. If (T - G) < 0, it implies that a country's tax revenue is insufficient to finance government spending.  
  
C. both a and b are true  
  
D. none of the above

C. both a and b are true

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A. If (S - I) < 0, it implies that a country's domestic savings is insufficient to finance domestic investment.  
  
B. If (T - G) < 0, it implies that a country's tax revenue is insufficient to finance government spending.  
  
C. When BCA is negative, it implies that government budget deficits an/or part of domestic investment are being finance with foreign-controlled capital.  
  
D. All of the above are true

D. All of the above are true

There is an intimate relationship between a country's BCA and how the country finances its domestic investment and pays for government expenditures. Given this, which of the following is a true statement?  
  
  
A. If (S - I) < 0, it implies that a country's domestic savings is insufficient to finance domestic investment.  
  
B. If (T - G) < 0, it implies that a country's tax revenue is insufficient to finance government spending.  
  
C. When BCA is negative, it implies that government budget deficits an/or part of domestic investment are being finance with foreign-controlled capital.  
  
D. All of the above are true.

D. All of the above are true.

There is an intimate relationship between a country's BCA and how the country finances its domestic investment and pays for government expenditures. This relationship is given by BCA ≡ X - M ≡ (S - I) + (T - G). Given this, in order for a country to reduce a BCA deficit, which of the following must occur?  
  
  
A. For a given level of S and I, the government budget deficit (T - G) must be reduced.  
  
B. For a given level of I and (T - G), S must be increased.  
  
C. For a given level of S and (T - G), I must fall.  
  
D. All of the above would work to reduce a BCA deficit.

D. All of the above would work to reduce a BCA deficit.

There is an intimate relationship between a country's BCA and how the country finances its domestic investment and pays for government expenditures. Given this, in order for a country to reduce a BCA deficit, which of the following must occur?  
  
  
A. For a given level of S and I, the government budget deficit (T - G) must be reduced.  
  
B. For a given level of I and (T - G), S must be increased.  
  
C. For a given level of S and (T - G), I must fall.  
  
D. All of the above would work to reduce a BCA deficit.

D. All of the above would work to reduce a BCA deficit.

**CHAP 5**

 The world's largest foreign exchange trading center is  
  
  
A. New York.  
  
B. Tokyo.  
  
C. London.  
  
D. Hong Kong.

C. London.

On average, worldwide daily trading of foreign exchange is closest to  
  
  
A. impossible to estimate.  
  
B. $15 billion.  
  
C. $504 billion.  
  
D. $3.21 trillion.

D. $3.21 trillion.

The foreign exchange market closes  
  
  
A. Never.  
  
B. 4:00 p.m. EST (New York time).  
  
C. 4:00 p.m. GMT (London time).  
  
D. 4:00 p.m. (Tokyo time).

A. Never.

Most foreign exchange transactions are for  
  
  
A. intervention by central banks.  
  
B. interbank trades between international banks or nonbank dealers.  
  
C. retail trade.  
  
D. purchase of hard currencies.

B. interbank trades between international banks or nonbank dealers.

The difference between a broker and a dealer is  
  
  
A. dealers sell drugs; brokers sell houses.  
  
B. brokers bring together buyers and sellers, but carry no inventory; dealers stand ready to buy and sell from their inventory.  
  
C. brokers transact in stocks and bonds; currency is bought and sold through dealers.  
  
D. none of the above

B. brokers bring together buyers and sellers, but carry no inventory; dealers stand ready to buy and sell from their inventory.

Most interbank trades are  
  
  
A. speculative or arbitrage transactions.  
  
B. simple order processing for the retail client.  
  
C. overnight loans from one bank to another.  
  
D. brokered by dealers.

A. speculative or arbitrage transactions.

At the wholesale level  
  
  
A. most trading takes place OTC between individuals on the floor of the exchange.  
  
B. most trading takes place over the phone.  
  
C. most trading flows over Reuters and EBS platforms.  
  
D. most trading flows through specialized "broking" firms.

C. most trading flows over Reuters and EBS platforms.

Intervention in the foreign exchange market is the process of  
  
  
A. a central bank requiring the commercial banks of that country to trade at a set price level.  
  
B. commercial banks in different countries coordinating efforts in order to stabilize one or more currencies.  
  
C. a central bank buying or selling its currency in order to influence its value.  
  
D. the government of a country prohibiting transactions in one or more currencies.

C. a central bank buying or selling its currency in order to influence its value.

The standard size foreign exchange transactions are for  
  
  
A. $10 million U.S.  
  
B. $1 million U.S.  
  
C. €1 million.

A. $10 million U.S.

Consider a U.S. importer desiring to purchase merchandise from a Dutch exporter invoiced in euros, at a cost of €512,100. The U.S. importer will contact his U.S. bank (where of course he has an account denominated in U.S. dollars) and inquire about the exchange rate, which the bank quotes as €1.0242/$1.00. The importer accepts this price, so his bank will \_\_\_\_\_\_\_\_\_\_\_\_ the importer's account in the amount of \_\_\_\_\_\_\_\_\_\_\_\_.  
  
  
A. Debit; $500,000  
  
B. Credit; €512,100  
  
C. Credit; $500,000  
  
D. Debit; €512,100

A. Debit; $500,000

The current exchange rate is £1.00 = $2.00. Compute the correct balances in Bank A's correspondent account(s) with Bank B if a currency trader employed at Bank A buys £45,000 from a currency trader at Bank B for $90,000 using its correspondent relationship with Bank B.  
  
  
A. Bank A's dollar-denominated account at B will fall by $90,000.  
  
B. Bank B's dollar-denominated account at A will rise by $90,000.  
  
C. Bank A's pound-denominated account at B will rise by £45,000.  
  
D. Bank B's pound-denominated account at A will fall by £45,000.  
  
E. All of the above are correct

E. All of the above are correct

The current exchange rate is £1.00 = $2.00. Compute the correct balances in Bank A's correspondent account(s) with Bank B if a currency trader employed at Bank A buys £45,000 from a currency trader at Bank B for $90,000 using its correspondent relationship with Bank B.  
  
  
A. Bank A's dollar-denominated account at B will rise by $90,000.  
  
B. Bank B's dollar-denominated account at A will fall by $90,000.  
  
C. Bank A's pound-denominated account at B will rise by £45,000.  
  
D. Bank B's pound-denominated account at A will rise by £45,000.

C. Bank A's pound-denominated account at B will rise by £45,000.

The current exchange rate is €1.00 = $1.50. Compute the correct balances in Bank A's correspondent account(s) with Bank B if a currency trader employed at Bank A buys €100,000 from a currency trader at Bank B for $150,000 using its correspondent relationship with Bank B.  
  
  
A. Bank A's dollar-denominated account at B will fall by $150,000.  
  
B. Bank B's dollar-denominated account at A will fall by $150,000.  
  
C. Bank A's pound-denominated account at B will fall by €100,000.  
  
D. Bank B's pound-denominated account at A will rise by €100,000.

A. Bank A's dollar-denominated account at B will fall by $150,000.

The spot market  
  
  
A. involves the almost-immediate purchase or sale of foreign exchange.  
  
B. involves the sale of futures, forwards, and options on foreign exchange.  
  
C. takes place only on the floor of a physical exchange.  
  
D. all of the above.

A. involves the almost-immediate purchase or sale of foreign exchange.

Spot foreign exchange trading  
  
  
A. accounts for about 5 percent of all foreign exchange trading.  
  
B. accounts for about 20 percent of all foreign exchange trading.  
  
C. accounts for about 33 percent of all foreign exchange trading.  
  
D. accounts for about 70 percent of all foreign exchange trading.

C. accounts for about 33 percent of all foreign exchange trading.

16.  
  
Using the table shown, what is the most current spot exchange rate shown for British pounds? Use a direct quote from a U.S. perspective.  
  
  
A. $1.61 = £1.00  
  
B. $1.60 = £1.00  
  
C. $1.00 = £0.625  
  
D. $1.72 = £1.00

A. $1.61 = £1.00

Suppose that the current exchange rate is €0.80 = $1.00. The direct quote, from the U.S. perspective is  
  
  
A. €1.00 = $1.25.  
  
B. €0.80 = $1.00.  
  
C. £1.00 = $1.80.  
  
D. None of the above

A. €1.00 = $1.25.

Suppose that the current exchange rate is €1.00 = $1.60. The indirect quote, from the U.S. perspective is  
  
  
A. €1.00 = $1.60.  
  
B. €0.6250 = $1.00.  
  
C. €1.60 = $1.00.  
  
D. None of the above

B. €0.6250 = $1.00.

Suppose that the current exchange rate is £1.00 = $2.00. The indirect quote, from the U.S. perspective is  
  
  
A. £1.00 = $2.00.  
  
B. £1.00 = $0.50.  
  
C. £0.50 = $1.00.  
  
D. None of the above

C. £0.50 = $1.00.

Indirect exchange rate quotations from the U.S. perspective are  
  
  
A. the price of one unit of the foreign currency in terms of the U.S. dollar.  
  
B. the price of one U.S. dollar in the foreign currency.

B. the price of one U.S. dollar in the foreign currency.

It is common practice among currency traders worldwide to both price and trade currencies against the U.S. dollar. In fact, 2007 BIS statistics indicate that about \_\_\_\_\_\_ percent of currency trading in the world involves the U.S. dollar on one side of the transaction.  
  
  
A. 86 percent  
  
B. 75 percent  
  
C. 45 percent  
  
D. 15 percent

A. 86 percent

It is common practice among currency traders worldwide to both price and trade currencies against the U.S. dollar. Consider a currency dealer who makes a market in 5 currencies against the dollar. If he were to supply quotes for each currency in terms of all of the others, how many quotes would he have to provide?  
  
  
A. 36  
  
B. 30  
  
C. 60  
  
D. 120  
  
E. None of the above

B. 30

The Bid price  
  
  
A. is the price that the dealer has just paid for something, his historical cost of the most recent trade.  
  
B. is the price that a dealer stands ready to pay.  
  
C. refers only to auctions like eBay, not over the counter transactions with dealers.  
  
D. is the price that a dealer stands ready to sell at.

B. is the price that a dealer stands ready to pay.

Suppose the spot ask exchange rate, Sa($|£), is $1.90 = £1.00 and the spot bid exchange rate, Sb($|£), is $1.89 = £1.00. If you were to buy $10,000,000 worth of British pounds and then sell them five minutes later, how much of your $10,000,000 would be "eaten" by the bid-ask spread?  
  
  
A. $1,000,000  
  
B. $52,910.05  
  
C. $100,000  
  
D. $52,631.58

D. $52,631.58

If the $/€ bid and ask prices are $1.50/€ and $1.51/€, respectively, the corresponding €/$ bid and ask prices are  
  
  
A. €0.6667 and €0.6623.  
  
B. $1.51 and $1.50.  
  
C. €0.6623 and €0.6667.  
  
D. cannot be determined with the information given.

C. €0.6623 and €0.6667.

In conversation, interbank foreign exchange traders use a shorthand abbreviation in expressing spot currency quotations. Consider a $/£ bid-ask quote of $1.9072-$1.9077. The "big figure", assumed to be known to all traders is \_\_\_\_\_.  
  
  
A. 1.9077  
  
B. 1  
  
C. 1.90  
  
D. 77

C. 1.90

In conversation, interbank foreign exchange traders use a shorthand abbreviation in expressing spot currency quotations. Consider a $/£ bid-ask quote of $1.9072-$1.9077. The currency dealer would likely quote that as \_\_\_\_\_.  
  
  
A. 72-77  
  
B. 77-72  
  
C. 5 points  
  
D. None of the above

A. 72-77

In the Interbank market, the standard size of a trade among large banks in the major currencies is  
  
  
A. for the U.S.-dollar equivalent of $10,000,000,000.  
  
B. for the U.S.-dollar equivalent of $10,000,000.  
  
C. for the U.S.-dollar equivalent of $100,000.  
  
D. for the U.S.-dollar equivalent of $1,000.

B. for the U.S.-dollar equivalent of $10,000,000.

A dealer in British pounds who thinks that the pound is about to appreciate  
  
  
A. may want to widen his bid-ask spread by raising his ask price.  
  
B. may want to lower his bid price.  
  
C. may want to lower his ask price.  
  
D. none of the above

D. none of the above

A dealer in British pounds who thinks that the pound is about to depreciate  
  
  
A. may want to widen his bid-ask spread by raising his ask price.  
  
B. may want to lower his bid price and his ask price.  
  
C. may want to lower his ask price.  
  
D. none of the above.

B. may want to lower his bid price and his ask price.

A dealer in pounds who thinks that the exchange rate is about to increase in volatility  
  
  
A. may want to widen his bid-ask spread.  
  
B. may want to decrease his bid-ask spread.  
  
C. may want to lower his ask price.  
  
D. none of the above.

A. may want to widen his bid-ask spread.

32.  
  
Using the table shown, what is the spot cross-exchange rate between pounds and euro?  
  
  
A. €1.00 = £0.75  
  
B. £1.33 = €1.00  
  
C. £1.00 = €0.75  
  
D. none of the above

A. €1.00 = £0.75

Nâng cấp để gỡ bỏ quảng cáo

**Chỉ 3,99 US$ / tháng**

The dollar-euro exchange rate is $1.25 = €1.00 and the dollar-yen exchange rate is ¥100 = $1.00. What is the euro-yen cross rate?  
  
  
A. ¥125 = €1.00  
  
B. ¥1.00 = €125  
  
C. ¥1.00 = €0.80  
  
D. None of the above

A. ¥125 = €1.00

Suppose you observe the following exchange rates: €1 = $1.25; £1 = $2.00. Calculate the euro-pound exchange rate.  
  
  
A. €1 = £1.60  
  
B. €1 = £0.625  
  
C. €2.50 = £1  
  
D. €1 = £2.50

A. €1 = £1.60

The AUD/$ spot exchange rate is AUD1.60/$ and the SF/$ is SF1.25/$. The AUD/SF cross exchange rate is \_\_\_\_\_.  
  
  
A. 0.7813  
  
B. 2.0000  
  
C. 1.2800  
  
D. 0.3500

C. 1.2800

Suppose you observe the following exchange rates: €1 = $1.50; £1 = $2.00. Calculate the euro-pound exchange rate.  
  
  
A. €1.3333 = £1.00  
  
B. £1.3333 = €1.00  
  
C. €3.00 = £1  
  
D. €1.25 = £1.00

A. €1.3333 = £1.00

Suppose you observe the following exchange rates: €1 = $1.60; £1 = $2.00. Calculate the euro-pound exchange rate.  
  
  
A. €1.3333 = £1.00  
  
B. £1.3333 = €1.00  
  
C. €3.00 = £1  
  
D. €1.25 = £1.00

D. €1.25 = £1.00

Suppose you observe the following exchange rates: €1 = $1.50; ¥120 = $1.00. Calculate the euro-pound exchange rate.  
  
  
A. ¥133.33 = €1.00  
  
B. €1.00 = ¥180  
  
C. ¥80 = €1.00  
  
D. €1 = £2.50

A. ¥133.33 = €1.00

Suppose you observe the following exchange rates: €1 = $1.45; £1 = $1.90. Calculate the euro-pound exchange rate.  
  
  
A. €1.3103 = £1.00  
  
B. £1.3333 = €1.00  
  
C. €2.00 = £1  
  
D. €3 = £1

A. €1.3103 = £1.00

40. What is the BID cross-exchange rate for Swiss Francs priced in euro?  
Hint: Find the price that a currency dealer will pay in euro to buy Swiss francs.  
  
  
A. €0.5386/CHF  
  
B. €0.5389/CHF  
  
C. €0.5463/CHF  
  
D. €0.5466/CHF

A. €0.5386/CHF

41. What is the ASK cross-exchange rate for Swiss Francs priced in euro?  
Hint: Find the price that a currency dealer will take in euro to sell Swiss francs.  
  
  
A. €0.5386/CHF  
  
B. €0.5389/CHF  
  
C. €0.5463/CHF  
  
D. €0.5466/CHF

D. €0.5466/CHF

Find the no-arbitrage cross exchange rate. The dollar-euro exchange rate is quoted as $1.60 = €1.00 and the dollar-pound exchange rate is quoted at $2.00 = £1.00.  
  
  
A. €1.25/£1.00  
  
B. $1.25/£1.00  
  
C. £1.25/€1.00  
  
D. €0.80/£1.00

A. €1.25/£1.00

Nâng cấp để gỡ bỏ quảng cáo

**Chỉ 3,99 US$ / tháng**

43. What is the BID cross-exchange rate for Canadian dollars priced in euro?  
Hint: Find the price that a currency dealer will pay in euro to buy Canadian dollars.  
  
  
A. €0.6094/CAD  
  
B. €0.6104/CAD  
  
C. €0.6181/CAD  
  
D. €0.6191/CAD

A. €0.6094/CAD

44. What is the ASK cross-exchange rate for Canadian dollars priced in euro?  
Hint: Find the price that a currency dealer will take in euro to sell Canadian dollars.  
  
  
A. €0.6094/CAD  
  
B. €0.6104/CAD  
  
C. €0.6181/CAD  
  
D. €0.6191/CAD

D. €0.6191/CAD

45. Find the no-arbitrage cross exchange rate. The dollar-euro exchange rate is quoted as $1.60 = €1.00 and the dollar-yen exchange rate is quoted at $1.00 = ¥120.  
  
  
A. ¥192/€1.00  
  
B. €1.92/¥100  
  
C. €1.25/¥1.00  
  
D. €1.00/¥1.92

A. ¥192/€1.00

The euro-pound cross exchange rate can be computed as:  
  
  
A. S(€/£) = S($/£) × S(€/$)  
  
B.  
  
  
C.  
  
  
D. all of the above

D. all of the above

Suppose a bank customer wishes to trade out of British pounds and into Swiss francs.  
  
  
A. In dealer jargon, this is a currency against currency trade.  
  
B. The bank will frequently handle such a trade by selling British pounds for U.S. dollars and then buying Swiss francs with U.S. dollars.  
  
C. The bank would typically sell the British pounds directly for Swiss francs.  
  
D. Both a and b

D. Both a and b

Including the transactions costs of the bid-ask spread, the euro-pound cross exchange rate for a customer who wants to sell euro and buy pounds can be computed as  
  
  
A.  
  
B.  
  
C.  
  
  
D. All of the above

D. All of the above

Suppose a bank customer with €1,000,000 wishes to trade out of euro and into Japanese yen. The dollar-euro exchange rate is quoted as $1.60 = €1.00 and the dollar-yen exchange rate is quoted at $1.00 = ¥120. How many yen will the customer get?  
  
  
A. ¥192,000,000  
  
B. ¥5,208,333  
  
C. ¥75,000,000  
  
D. ¥5,208.33

A. ¥192,000,000

Suppose you observe the following exchange rates: €1 = $.85; £1 = $1.60; and €2.00 = £1.00. Starting with $1,000,000, how can you make money?  
  
  
A. Exchange $1m for £625,000 at £1 = $1.60. Buy €1,250,000 at €2 = £1.00; trade for $1,062,500 at €1 = $.85.  
  
B. Start with dollars, exchange for euros at €1 = $.85; exchange for pounds at €2.00 = £1.00; exchange for dollars at £1 = $1.60.  
  
C. Start with euros; exchange for pounds; exchange for dollars; exchange for euros.  
  
D. No arbitrage profit is possible.

A. Exchange $1m for £625,000 at £1 = $1.60. Buy €1,250,000 at €2 = £1.00; trade for $1,062,500 at €1 = $.85.

You are a U.S.-based treasurer with $1,000,000 to invest. The dollar-euro exchange rate is quoted as $1.20 = €1.00 and the dollar-pound exchange rate is quoted at $1.80 = £1.00. If a bank quotes you a cross rate of £1.00 = €1.50 how much money can an astute trader make?  
  
  
A. No arbitrage is possible  
  
B. $1,160,000  
  
C. $500,000  
  
D. $250,000

A. No arbitrage is possible

You are a U.S.-based treasurer with $1,000,000 to invest. The dollar-euro exchange rate is quoted as $1.60 = €1.00 and the dollar-pound exchange rate is quoted at $2.00 = £1.00. If a bank quotes you a cross rate of £1.00 = €1.20 how much money can an astute trader make?  
  
  
A. No arbitrage is possible  
  
B. $1,160,000  
  
C. $41,667  
  
D. $40,000

C. $41,667

You are a U.S.-based treasurer with $1,000,000 to invest. The dollar-euro exchange rate is quoted as $1.60 = €1.00 and the dollar-pound exchange rate is quoted at $2.00 = £1.00. If a bank quotes you a cross rate of £1.00 = €1.20 how can you make money?  
  
  
A. No arbitrage is possible  
  
B. Buy euro at $1.60/€, buy £ at €1.20/£, sell £ at $2/£  
  
C. Buy £ $2/£, buy € at €1.20/£, sell € at $1.60/€

B. Buy euro at $1.60/€, buy £ at €1.20/£, sell £ at $2/£

The Singapore dollar—U.S. dollar (S$/$) spot exchange rate is S$1.60/$, the Canadian dollar—U.S. dollar (CD/$) spot rate is CD1.33/$ and the S$/CD1.15. Determine the triangular arbitrage profit that is possible if you have $1,000,000.  
  
  
A. $44,063 profit  
  
B. $46,093 loss  
  
C. No profit is possible  
  
D. $46,093 profit

D. $46,093 profit

You are a U.S.-based treasurer with $1,000,000 to invest. The dollar-euro exchange rate is quoted as $1.50 = €1.00 and the dollar-pound exchange rate is quoted at $2.00 = £1.00. If a bank quotes you a cross rate of £1.00 = €1.25 how can you make money?  
  
  
A. No arbitrage is possible.  
  
B. Buy euro at $1.50/€, buy £ at €1.25/£, sell £ at $2/£.  
  
C. Buy £ $2/£, buy € at €1.25/£, sell € at $1.50/€.

B. Buy euro at $1.50/€, buy £ at €1.25/£, sell £ at $2/£.

Market microstructure refers to  
  
  
A. the basic mechanics of how a marketplace operates.  
  
B. the basics of how to make small (micro-sized) currency trades.  
  
C. how macroeconomic variables such as GDP and inflation are determined.  
  
D. none of the above

A. the basic mechanics of how a marketplace operates.

A recent survey of U.S. foreign exchange traders measured traders perceptions about how fast news events that cause movements in exchange rates actually change the exchange rate. The survey respondents claim that the bulk of the adjustment to economic announcements regarding unemployment, trade deficits, inflation, GDP, and the Federal funds rate takes place within  
  
  
A. ten seconds.  
  
B. one minute.  
  
C. five minutes.  
  
D. one hour.

B. one minute.

The forward price  
  
  
A. may be higher than the spot price.  
  
B. may be the same as the spot price.  
  
C. may be less than the spot price.  
  
D. all of the above

D. all of the above

Relative to the spot price the forward price will be  
  
  
A. usually less than the spot price.  
  
B. usually more than the spot price.  
  
C. usually equal to the spot price.  
  
D. usually less than or more than the spot price more often than it is equal to the spot price.

D. usually less than or more than the spot price more often than it is equal to the spot price.

For a U.S. trader working in American quotes, if the forward price is higher than the spot price  
  
  
A. the currency is trading at a premium in the forward market.  
  
B. the currency is trading at a discount in the forward market.  
  
C. then you should buy at the spot, hold on to it and sell at the forward—it's a built-in arbitrage.  
  
D. all of the above—it really depends if you're talking American or European quotes.

A. the currency is trading at a premium in the forward market.

The forward market  
  
  
A. involves contracting today for the future purchase of sale of foreign exchange at the spot rate that will prevail at the maturity of the contract.  
  
B. involves contracting today for the future purchase of sale of foreign exchange at a price agreed upon today.  
  
C. involves contracting today for the right but not obligation to the future purchase of sale of foreign exchange at a price agreed upon today.  
  
D. none of the above

B. involves contracting today for the future purchase of sale of foreign exchange at a price agreed upon today.

The $/CD spot bid-ask rates are $0.7560-$0.7625. The 3-month forward points are 12-16. Determine the $/CD 3-month forward bid-ask rates.  
  
  
A. $0.7548-$0.7609  
  
B. $0.7572-$0.7641  
  
C. $0.7512-$0.7616  
  
D. cannot be determined with the information given

B. $0.7572-$0.7641

If one has agreed to buy foreign exchange forward  
  
  
A. you have a short position in the forward contract.  
  
B. you have a long position in the forward contract.  
  
C. until the exchange rate moves, you haven't made money, so you're neither short nor long.  
  
D. you have a long position in the spot market.

B. you have a long position in the forward contract.

The current spot exchange rate is $1.55/€ and the three-month forward rate is $1.50/€. You enter into a short position on €1,000. At maturity, the spot exchange rate is $1.60/€. How much have you made or lost?  
  
  
A. Lost $100  
  
B. Made €100  
  
C. Lost $50  
  
D. Made $150

A. Lost $100

The current spot exchange rate is $1.55/€ and the three-month forward rate is $1.50/€. Based on your analysis of the exchange rate, you are confident that the spot exchange rate will be $1.52/€ in three months. Assume that you would like to buy or sell €1,000,000. What actions do you need to take to speculate in the forward market?  
  
  
A. Take a long position in a forward contract on €1,000,000 at $1.50/€.  
  
B. Take a short position in a forward contract on €1,000,000 at $1.50/€.  
  
C. Buy euro today at the spot rate, sell them forward.  
  
D. Sell euro today at the spot rate, buy them forward.

A. Take a long position in a forward contract on €1,000,000 at $1.50/€.

The current spot exchange rate is $1.45/€ and the three-month forward rate is $1.55/€. Based upon your economic forecast, you are pretty confident that the spot exchange rate will be $1.50/€ in three months. Assume that you would like to buy or sell €100,000. What actions would you take to speculate in the forward market? How much will you make if your prediction is correct?  
  
  
A. Take a short position in a forward. If you're right you will make $15,000.  
  
B. Take a long position in a forward contract on euro. If you're right you will make $5,000.  
  
C. Take a short position in a forward contract on euro. If you're right you will make $5,000.  
  
D. Take a long position in a forward contract on euro. If you're right you will make $15,000.

C. Take a short position in a forward contract on euro. If you're right you will make $5,000.

Consider a trader who takes a long position in a six-month forward contract on the euro. The forward rate is $1.75 = €1.00; the contract size is €62,500. At the maturity of the contract the spot exchange rate is $1.65 = €1.00.  
  
  
A. The trader has lost $625.  
  
B. The trader has lost $6,250.  
  
C. The trader has made $6,250.  
  
D. The trader has lost $66,287.88.

B. The trader has lost $6,250.

The current spot exchange rate is $1.55/€ and the three-month forward rate is $1.50/€. Based on your analysis of the exchange rate, you are confident that the spot exchange rate will be $1.62/€ in three months. Assume that you would like to buy or sell €1,000,000. What actions do you need to take to speculate in the forward market? What is the expected dollar profit from speculation?  
  
  
A. Sell €1,000,000 forward for $1.50/€.  
  
B. Buy €1,000,000 forward for $1.50/€.  
  
C. Wait three months, if your forecast is correct buy €1,000,000 at $1.52/€.  
  
D. Buy €1,000,000 today at $1.55/€; wait three months, if your forecast is correct sell €1,000,000 at $1.62/€.

B. Buy €1,000,000 forward for $1.50/€.

The current spot exchange rate is $1.50/€ and the three-month forward rate is $1.55/€. Based on your analysis of the exchange rate, you are confident that the spot exchange rate will be $1.62/€ in three months. Assume that you would like to buy or sell €1,000,000. What actions do you need to take to speculate in the forward market? What is the expected dollar profit from speculation?  
  
  
A. Sell €1,000,000 forward for $1.50/€.  
  
B. Buy €1,000,000 forward for $1.55/€.  
  
C. Wait three months, if your forecast is correct buy €1,000,000 at $1.62/€.  
  
D. Buy €1,000,000 today at $1.50/€; wait three months, if your forecast is correct sell €1,000,000 at $1.62/€.

B. Buy €1,000,000 forward for $1.55/€.

Which of the following are correct?  
  
  
A.  
  
  
B.  
  
  
C.  
  
  
D. All of the above are correct

D. All of the above are correct

76-78

...

When a currency trades at a premium in the forward market  
  
  
A. the exchange rate is more than one dollar (e.g. €1.00 = $1.28).  
  
B. the exchange rate is less than one dollar.  
  
C. the forward rate is less than the spot rate.  
  
D. the forward rate is more than the spot rate.

D. the forward rate is more than the spot rate.

When a currency trades at a discount in the forward market  
  
  
A. the forward rate is less than the spot rate.  
  
B. the forward rate is more than the spot rate.  
  
C. the forward exchange rate is less than one dollar (e.g. €1.00 = $0.928).  
  
D. the exchange rate is less than it was yesterday.

A. the forward rate is less than the spot rate.

The SF/$ spot exchange rate is SF1.25/$ and the 180 day forward exchange rate is SF1.30/$. The forward premium (discount) is  
  
  
A. the dollar is trading at an 8% premium to the Swiss franc for delivery in 180 days.  
  
B. the dollar is trading at a 4% premium to the Swiss franc for delivery in 180 days.  
  
C. the dollar is trading at an 8% discount to the Swiss franc for delivery in 180 days.  
  
D. the dollar is trading at a 4% discount to the Swiss franc for delivery in 180 days.

A. the dollar is trading at an 8% premium to the Swiss franc for delivery in 180 days.

The €/$ spot exchange rate is $1.50/€ and the 120 day forward exchange rate is 1.45/€. The forward premium (discount) is  
  
  
A. the dollar is trading at an 8% premium to the euro for delivery in 120 days.  
  
B. the dollar is trading at a 5% premium to the Swiss franc for delivery in 120 days.  
  
C. the dollar is trading at a 10% discount to the euro for delivery in 120 days.  
  
D. the dollar is trading at a 5% discount to the euro for delivery in 120 days.

C. the dollar is trading at a 10% discount to the euro for delivery in 120 days.

The €/$ spot exchange rate is $1.50/€ and the 90-day forward premium is 10 percent. Find the 90-day forward price.  
  
  
A. $1.65/€  
  
B. $1.5375/€  
  
C. $1.9125/€  
  
D. None of the above

B. $1.5375/€

The SF/$ spot exchange rate is SF1.25/$ and the 180 day forward premium is 8 percent. What is the outright 180 day forward exchange rate?  
  
  
A. SF1.30/$  
  
B. SF1.35/$  
  
C. SF6.25/$  
  
D. None of the above

A. SF1.30/$

The SF/$ 180-day forward exchange rate is SF1.30/$ and the 180 day forward premium is 8 percent. What is the outright spot exchange rate?  
  
  
A. SF1.30/$  
  
B. SF1.35/$  
  
C. SF1.25/$  
  
D. None of the above

C. SF1.25/$

Consider the following spot and forward rate quotations for the Swiss franc:  
  
  
  
Which of the following is true:  
  
  
A. The Swiss franc is definitely going to be worth more dollars in six months.  
  
B. The Swiss franc is probably going to be worth less in dollars in six months.  
  
C. The Swiss franc is trading at a forward discount.  
  
D. The Swiss franc is trading at a forward premium.

D. The Swiss franc is trading at a forward premium.

Consider the following spot and forward rate quotations for the Swiss franc:  
  
  
  
Calculate the 3-month forward premium in American terms. Assume 30-360 pricing convention.  
  
  
A. 0.353.  
  
B. 0.4235.  
  
C. 0.1364.  
  
D. 0.1412.

D. 0.1412.

Swap transactions  
  
  
A. involve the simultaneous sale (or purchase) of spot foreign exchange against a forward purchase (or sale) of approximately an equal amount of the foreign currency.  
  
B. account for about half of Interbank FX trading.  
  
C. involve trades of one foreign currency for another without going through the U.S. dollar.  
  
D. all of the above

A. involve the simultaneous sale (or purchase) of spot foreign exchange against a forward purchase (or sale) of approximately an equal amount of the foreign currency.

As a rule, when the interest rate of the foreign currency is greater than the interest rate of the quoting currency,  
  
  
A. the outright forward rate is less than the spot exchange rate.  
  
B. the outright forward rate is more than the spot exchange rate.  
  
C. the currency will trade at a premium in the forward contract.  
  
D. none of the above

A. the outright forward rate is less than the spot exchange rate.

Bank dealers in conversations among themselves use a shorthand notation to quote bid and ask forward prices in terms of forward points. This is convenient because  
  
  
A. forward points may change faster than spot and forward quotes.  
  
B. forward points may remain constant for long periods of time, even if the spot rates change frequently.  
  
C. traders who are looking for violations of covered interest arbitrage are less interested in the actual spot and forward exchange rates, but are interested in the premium or discount differential measured in forward points.  
  
D. both c and d are correct

D. both c and d are correct

91. Bank dealers in conversations among themselves use a shorthand notation to quote bid and ask forward prices in terms of forward points. Complete the following table:  
  
  
  
  
A. 1.9040-1.9047  
  
B. 1.9042-1.9049  
  
C. 1.9032-1.9030  
  
D. none of the above

A. 1.9040-1.9047

An exchange-traded fund (ETF) is  
  
  
A. the same thing as a mutual fund.  
  
B. a portfolio of financial assets in which shares representing fractional ownership of the fund are sold and redeemed by the fund sponsor.  
  
C. a portfolio of financial assets in which shares representing fractional ownership of the fund trade on an organized exchange.  
  
D. none of the above.

C. a portfolio of financial assets in which shares representing fractional ownership of the fund trade on an organized exchange.

The largest and most active financial market in the world is  
  
  
A. the Fleet Street Exchange in London.  
  
B. the NYSE in New York.  
  
C. the FX market.  
  
D. none of the above.

C. the FX market.

Nondollar currency transactions  
  
  
A. are priced by looking at the price that must exist to eliminate arbitrage.  
  
B. allow for triangular arbitrage opportunities to keep the currency dealers employed.  
  
C. are only for poor people who don't have dollars.  
  
D. none of the above

A. are priced by looking at the price that must exist to eliminate arbitrage.

**CHAP 6**

An arbitrage is best defined as  
  
  
A. a legal condition imposed by the CFTC.  
  
B. the act of simultaneously buying and selling the same or equivalent assets or commodities for the purpose of making reasonable profits.  
  
C. the act of simultaneously buying and selling the same or equivalent assets or commodities for the purpose of making guaranteed profits.  
  
D. None of the above

C. the act of simultaneously buying and selling the same or equivalent assets or commodities for the purpose of making guaranteed profits.

Interest Rate Parity (IRP) is best defined as  
  
  
A. when a government brings its domestic interest rate in line with other major financial markets.  
  
B. when the central bank of a country brings its domestic interest rate in line with its major trading partners.  
  
C. an arbitrage condition that must hold when international financial markets are in equilibrium.  
  
D. None of the above

C. an arbitrage condition that must hold when international financial markets are in equilibrium.

When Interest Rate Parity (IRP) does not hold  
  
  
A. there is usually a high degree of inflation in at least one country.  
  
B. the financial markets are in equilibrium.  
  
C. there are opportunities for covered interest arbitrage.  
  
D. both b and c

C. there are opportunities for covered interest arbitrage.

Suppose you observe a spot exchange rate of $1.50/€. If interest rates are 5% APR in the U.S. and 3% APR in the euro zone, what is the no-arbitrage 1-year forward rate?  
  
  
A. €1.5291/$  
  
B. $1.5291/€  
  
C. €1.4714/$  
  
D. $1.4714/€

B. $1.5291/€

Suppose you observe a spot exchange rate of $1.50/€. If interest rates are 3% APR in the U.S. and 5% APR in the euro zone, what is the no-arbitrage 1-year forward rate?  
  
  
A. €1.5291/$  
  
B. $1.5291/€  
  
C. €1.4714/$  
  
D. $1.4714/€

D. $1.4714/€

Suppose you observe a spot exchange rate of $2.00/£. If interest rates are 5% APR in the U.S. and 2% APR in the U.K., what is the no-arbitrage 1-year forward rate?  
  
  
A. £2.0588/$  
  
B. $2.0588/£  
  
C. £1.9429/$  
  
D. $1.9429/£

B. $2.0588/£

Suppose that the one-year interest rate is 5.0 percent in the United States; the spot exchange rate is $1.20/€; and the one-year forward exchange rate is $1.16/€. What must one-year interest rate be in the euro zone to avoid arbitrage?  
  
  
A. 5.0%  
  
B. 6.09%  
  
C. 8.62%  
  
D. None of the above

C. 8.62%

Suppose that the one-year interest rate is 3.0 percent in the Italy, the spot exchange rate is $1.20/€, and the one-year forward exchange rate is $1.18/€. What must one-year interest rate be in the United States?  
  
  
A. 1.2833%  
  
B. 1.0128%  
  
C. 4.75%  
  
D. None of the above

A. 1.2833%

Suppose that the one-year interest rate is 4.0 percent in the Italy, the spot exchange rate is $1.60/€, and the one-year forward exchange rate is $1.58/€. What must one-year interest rate be in the United States?  
  
  
A. 2%  
  
B. 2.7%  
  
C. 5.32%  
  
D. None of the above

B. 2.7%

Covered Interest Arbitrage (CIA) activities will result in  
  
  
A. an unstable international financial markets.  
  
B. restoring equilibrium prices quickly.  
  
C. a disintermediation.  
  
D. no effect on the market.

B. restoring equilibrium prices quickly.

Suppose that the one-year interest rate is 5.0 percent in the United States and 3.5 percent in Germany, and that the spot exchange rate is $1.12/€ and the one-year forward exchange rate, is $1.16/€. Assume that an arbitrageur can borrow up to $1,000,000.  
  
  
A. This is an example where interest rate parity holds.  
  
B. This is an example of an arbitrage opportunity; interest rate parity does NOT hold.  
  
C. This is an example of a Purchasing Power Parity violation and an arbitrage opportunity.  
  
D. None of the above

B. This is an example of an arbitrage opportunity; interest rate parity does NOT hold.

Suppose that you are the treasurer of IBM with an extra U.S. $1,000,000 to invest for six months. You are considering the purchase of U.S. T-bills that yield 1.810% (that's a six month rate, not an annual rate by the way) and have a maturity of 26 weeks. The spot exchange rate is $1.00 = ¥100, and the six month forward rate is $1.00 = ¥110. The interest rate in Japan (on an investment of comparable risk) is 13 percent. What is your strategy?  
  
  
A. Take $1m, invest in U.S. T-bills.  
  
B. Take $1m, translate into yen at the spot, invest in Japan, and repatriate your yen earnings back into dollars at the spot rate prevailing in six months.  
  
C. Take $1m, translate into yen at the spot, invest in Japan, hedge with a short position in the forward contract.  
  
D. Take $1m, translate into yen at the forward rate, invest in Japan, hedge with a short position in the spot contract.

C. Take $1m, translate into yen at the spot, invest in Japan, hedge with a short position in the forward contract.

Suppose that the annual interest rate is 2.0 percent in the United States and 4 percent in Germany, and that the spot exchange rate is $1.60/€ and the forward exchange rate, with one-year maturity, is $1.58/€. Assume that an arbitrager can borrow up to $1,000,000 or €625,000. If an astute trader finds an arbitrage, what is the net cash flow in one year?  
  
  
A. $238.65  
  
B. $14,000  
  
C. $46,207  
  
D. $7,000

D. $7,000

15. A currency dealer has good credit and can borrow either $1,000,000 or €800,000 for one year. The one-year interest rate in the U.S. is i$ = 2% and in the euro zone the one-year interest rate is i€ = 6%. The spot exchange rate is $1.25 = €1.00 and the one-year forward exchange rate is $1.20 = €1.00. Show how to realize a certain profit via covered interest arbitrage.  
  
  
A. Borrow $1,000,000 at 2%. Trade $1,000,000 for €800,000; invest at i€ = 6%; translate proceeds back at forward rate of $1.20 = €1.00, gross proceeds = $1,017,600.  
  
B. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €848,000 back into euro at the forward rate of $1.20 = €1.00. Net profit $2,400.  
  
C. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €850,000 back into euro at the forward rate of $1.20 = €1.00. Net profit €2,000.  
  
D. Both c and b

D. Both c and b

Suppose that the annual interest rate is 5.0 percent in the United States and 3.5 percent in Germany, and that the spot exchange rate is $1.12/€ and the forward exchange rate, with one-year maturity, is $1.16/€. Assume that an arbitrager can borrow up to $1,000,000. If an astute trader finds an arbitrage, what is the net cash flow in one year?  
  
  
A. $10,690  
  
B. $15,000  
  
C. $46,207  
  
D. $21,964.29

D. $21,964.29

A U.S.-based currency dealer has good credit and can borrow $1,000,000 for one year. The one-year interest rate in the U.S. is i$ = 2% and in the euro zone the one-year interest rate is i€ = 6%. The spot exchange rate is $1.25 = €1.00 and the one-year forward exchange rate is $1.20 = €1.00. Show how to realize a certain dollar profit via covered interest arbitrage.  
  
  
A. Borrow $1,000,000 at 2%. Trade $1,000,000 for €800,000; invest at i€ = 6%; translate proceeds back at forward rate of $1.20 = €1.00, gross proceeds = $1,017,600.  
  
B. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €848,000 back into euro at the forward rate of $1.20 = €1.00. Net profit $2,400.  
  
C. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €850,000 back into euro at the forward rate of $1.20 = €1.00. Net profit €2,000.  
  
D. Both c and b

B. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €848,000 back into euro at the forward rate of $1.20 = €1.00. Net profit $2,400.

An Italian currency dealer has good credit and can borrow €800,000 for one year. The one-year interest rate in the U.S. is i$ = 2% and in the euro zone the one-year interest rate is i€ = 6%. The spot exchange rate is $1.25 = €1.00 and the one-year forward exchange rate is $1.20 = €1.00. Show how to realize a certain euro-denominated profit via covered interest arbitrage.  
  
  
A. Borrow $1,000,000 at 2%. Trade $1,000,000 for €800,000; invest at i€ = 6%; translate proceeds back at forward rate of $1.20 = €1.00, gross proceeds = $1,017,600.  
  
B. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €848,000 back into euro at the forward rate of $1.20 = €1.00. Net profit $2,400.  
  
C. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €850,000 back into euro at the forward rate of $1.20 = €1.00. Net profit €2,000.  
  
D. Both c and b

C. Borrow €800,000 at i€ = 6%; translate to dollars at the spot, invest in the U.S. at i$ = 2% for one year; translate €850,000 back into euro at the forward rate of $1.20 = €1.00. Net profit €2,000.

Suppose that you are the treasurer of IBM with an extra U.S. $1,000,000 to invest for six months. You are considering the purchase of U.S. T-bills that yield 1.810% (that's a six month rate, not an annual rate by the way) and have a maturity of 26 weeks. The spot exchange rate is $1.00 = ¥100, and the six month forward rate is $1.00 = ¥110. What must the interest rate in Japan (on an investment of comparable risk) be before you are willing to consider investing there for six months?  
  
  
A. 11.991%  
  
B. 1.12%  
  
C. 7.45%  
  
D. -7.45%

A. 11.991%

How high does the lending rate in the euro zone have to be before an arbitrageur would NOT consider borrowing dollars, trading for euro at the spot, investing in the euro zone and hedging with a short position in the forward contract?  
  
  
  
  
A. The bid-ask spreads are too wide for any profitable arbitrage when i€ > 0  
  
B. 3.48%  
  
C. -2.09%  
  
D. None of the above

B. 3.48%

Suppose that the one-year interest rate is 5.0 percent in the United States and 3.5 percent in Germany, and the one-year forward exchange rate is $1.16/€. What must the spot exchange rate be?  
  
  
A. $1.1768/€  
  
B. $1.1434/€  
  
C. $1.12/€  
  
D. None of the above

B. $1.1434/€

A higher U.S. interest rate (i$ ↑) will result in  
  
  
A. a stronger dollar.  
  
B. a lower spot exchange rate (expressed as foreign currency per U.S. dollar).  
  
C. both a and b  
  
D. none of the above

A. a stronger dollar.

If the interest rate in the U.S. is i$ = 5 percent for the next year and interest rate in the U.K. is i£ = 8 percent for the next year, uncovered IRP suggests that  
  
  
A. the pound is expected to depreciate against the dollar by about 3 percent.  
  
B. the pound is expected to appreciate against the dollar by about 3 percent.  
  
C. the dollar is expected to appreciate against the pound by about 3 percent.  
  
D. both a and c

D. both a and c

A currency dealer has good credit and can borrow either $1,000,000 or €800,000 for one year. The one-year interest rate in the U.S. is i$ = 2% and in the euro zone the one-year interest rate is i€ = 6%. The one-year forward exchange rate is $1.20 = €1.00; what must the spot rate be to eliminate arbitrage opportunities?  
  
  
A. $1.2471 = €1.00  
  
B. $1.20 = €1.00  
  
C. $1.1547 = €1.00  
  
D. none of the above

A. $1.2471 = €1.00

24. Will an arbitrageur facing the following prices be able to make money?  
  
  
  
  
A. Yes, borrow $1,000 at 5%; Trade for € at the ask spot rate $1.01 = €1.00; Invest €990.10 at 5.5%; Hedge this with a forward contract on €1,044.55 at $0.99 = €1.00; Receive $1.034.11.  
  
B. Yes, borrow €1,000 at 6%; Trade for $ at the bid spot rate $1.00 = €1.00; Invest $1,000 at 4.5%; Hedge this with a forward contract on €1,045 at $1.00 = €1.00.  
  
C. No; the transactions costs are too high.  
  
D. None of the above

C. No; the transactions costs are too high.

If IRP fails to hold  
  
  
A. pressure from arbitrageurs should bring exchange rates and interest rates back into line.  
  
B. it may fail to hold due to transactions costs.  
  
C. it may be due to government-imposed capital controls.  
  
D. all of the above

D. all of the above

Although IRP tends to hold, it may not hold precisely all the time  
  
  
A. due to transactions costs, like the bid ask spread.  
  
B. due to asymmetric information.  
  
C. due to capital controls imposed by governments.  
  
D. both a and c

D. both a and c

28. Consider a bank dealer who faces the following spot rates and interest rates. What should he set his 1-year forward ask price at?  
  
  
  
  
A. $1.4324/€  
  
B. $1.4358/€  
  
C. $1.4662/€  
  
D. $1.4676/€

C. $1.4662/€

29. Consider a bank dealer who faces the following spot rates and interest rates. What should he set his 1-year forward bid price at?  
  
  
  
  
A. $1.4324/€  
  
B. $1.4358/€  
  
C. $1.4662/€  
  
D. $1.4676/€

B. $1.4358/€

Will an arbitrageur facing the following prices be able to make money?  
  
  
  
  
A. Yes, borrow €1,000,000 at 3.65%; Trade for $ at the bid spot rate $1.40 = €1.00; Invest at 4.1%; Hedge this with a long position in a forward contract.  
  
B. Yes, borrow $1,000,000 at 4.2%; Trade for € at the spot ask exchange rate $1.43 = €1.00; Invest €699,300.70 at 3.5%; Hedge this by going SHORT in forward (agree to sell € @ BID price of $1.44/€ in one year). Cash flow in 1 year $237.76.  
  
C. No; the transactions costs are too high.  
  
D. None of the above

B. Yes, borrow $1,000,000 at 4.2%; Trade for € at the spot ask exchange rate $1.43 = €1.00; Invest €699,300.70 at 3.5%; Hedge this by going SHORT in forward (agree to sell € @ BID price of $1.44/€ in one year). Cash flow in 1 year $237.76.

If a foreign county experiences a hyperinflation,  
  
  
A. its currency will depreciate against stable currencies.  
  
B. its currency may appreciate against stable currencies.  
  
C. its currency may be unaffected—it's difficult to say.  
  
D. none of the above

A. its currency will depreciate against stable currencies.

As of today, the spot exchange rate is €1.00 = $1.25 and the rates of inflation expected to prevail for the next year in the U.S. is 2% and 3% in the euro zone. What is the one-year forward rate that should prevail?  
  
  
A. €1.00 = $1.2379  
  
B. €1.00 = $1.2623  
  
C. €1.00 = $0.9903  
  
D. $1.00 = €1.2623

A. €1.00 = $1.2379

Purchasing Power Parity (PPP) theory states that  
  
  
A. the exchange rate between currencies of two countries should be equal to the ratio of the countries' price levels.  
  
B. as the purchasing power of a currency sharply declines (due to hyperinflation) that currency will depreciate against stable currencies.  
  
C. the prices of standard commodity baskets in two countries are not related.  
  
D. both a and b

D. both a and b

As of today, the spot exchange rate is €1.00 = $1.60 and the rates of inflation expected to prevail for the next year in the U.S. is 2% and 3% in the euro zone. What is the one-year forward rate that should prevail?  
  
  
A. €1.00 = $1.6157  
  
B. €1.6157 = $1.00  
  
C. €1.00 = $1.5845  
  
D. $1.00 × 1.03 = €1.60 × 1.02

C. €1.00 = $1.5845

If the annual inflation rate is 5.5 percent in the United States and 4 percent in the U.K., and the dollar depreciated against the pound by 3 percent, then the real exchange rate, assuming that PPP initially held, is  
  
  
A. 0.07.  
  
B. 0.9849.  
  
C. -0.0198.  
  
D. 4.5.

B. 0.9849.

If the annual inflation rate is 2.5 percent in the United States and 4 percent in the U.K., and the dollar appreciated against the pound by 1.5 percent, then the real exchange rate, assuming that PPP initially held, is \_\_\_\_\_.  
  
  
A. parity  
  
B. 0.9710  
  
C. -0.0198  
  
D. 4.5

B. 0.9710

In view of the fact that PPP is the manifestation of the law of one price applied to a standard commodity basket,  
  
  
A. it will hold only if the prices of the constituent commodities are equalized across countries in a given currency.  
  
B. it will hold only if the composition of the consumption basket is the same across countries.  
  
C. both a and b  
  
D. none of the above

C. both a and b

Some commodities never enter into international trade. Examples include  
  
  
A. nontradables.  
  
B. haircuts.  
  
C. housing.  
  
D. all of the above

D. all of the above

Generally unfavorable evidence on PPP suggests that  
  
  
A. substantial barriers to international commodity arbitrage exist.  
  
B. tariffs and quotas imposed on international trade can explain at least some of the evidence.  
  
C. shipping costs can make it difficult to directly compare commodity prices.  
  
D. all of the above

D. all of the above

The price of a McDonald's Big Mac sandwich  
  
  
A. is about the same in the 120 countries that McDonalds does business in.  
  
B. varies considerably across the world in dollar terms.  
  
C. supports PPP.  
  
D. none of the above.

B. varies considerably across the world in dollar terms.

The Fisher effect can be written for the United States as:  
  
  
  
  
A. Option A  
  
B. Option B  
  
C. Option C  
  
D. Option D

A. Option A

Forward parity states that  
  
  
A. any forward premium or discount is equal to the expected change in the exchange rate.  
  
B. any forward premium or discount is equal to the actual change in the exchange rate.  
  
C. the nominal interest rate differential reflects the expected change in the exchange rate.  
  
D. an increase (decrease) in the expected inflation rate in a country will cause a proportionate increase (decrease) in the interest rate in the country.

A. any forward premium or discount is equal to the expected change in the exchange rate.

The International Fisher Effect suggests that  
  
  
A. any forward premium or discount is equal to the expected change in the exchange rate.  
  
B. any forward premium or discount is equal to the actual change in the exchange rate.  
  
C. the nominal interest rate differential reflects the expected change in the exchange rate.  
  
D. an increase (decrease) in the expected inflation rate in a country will cause a proportionate increase (decrease) in the interest rate in the country.

C. the nominal interest rate differential reflects the expected change in the exchange rate.

The Fisher effect states that  
  
  
A. any forward premium or discount is equal to the expected change in the exchange rate.  
  
B. any forward premium or discount is equal to the actual change in the exchange rate.  
  
C. the nominal interest rate differential reflects the expected change in the exchange rate.  
  
D. an increase (decrease) in the expected inflation rate in a country will cause a proportionate increase (decrease) in the interest rate in the country.

D. an increase (decrease) in the expected inflation rate in a country will cause a proportionate increase (decrease) in the interest rate in the country.

If you could accurately and consistently forecast exchange rates  
  
  
A. this would be a very handy thing as girls prefer guys with skills.  
  
B. you could impress your dates.  
  
C. you could make a great deal of money.  
  
D. all of the above

D. all of the above

The main approaches to forecasting exchange rates are  
  
  
A. Efficient market, Fundamental, and Technical approaches.  
  
B. Efficient market and Technical approaches.  
  
C. Efficient market and Fundamental approaches.  
  
D. Fundamental and Technical approaches.

A. Efficient market, Fundamental, and Technical approaches.

The benefit to forecasting exchange rates  
  
  
A. are greatest during periods of fixed exchange rates.  
  
B. are nonexistent now that the euro and dollar are the biggest game in town.  
  
C. accrue to, and are a vital concern for, MNCs formulating international sourcing, production, financing and marketing strategies.  
  
D. all of the above

C. accrue to, and are a vital concern for, MNCs formulating international sourcing, production, financing and marketing strategies.

The Efficient Markets Hypothesis states  
  
  
A. markets tend to evolve to low transactions costs and speedy execution of orders.  
  
B. current asset prices (e.g. exchange rates) fully reflect all the available and relevant information.  
  
C. current exchange rates cannot be explained by such fundamental forces as money supplies, inflation rates and so forth.  
  
D. none of the above

B. current asset prices (e.g. exchange rates) fully reflect all the available and relevant information.

Good, inexpensive, and fairly reliable predictors of future exchange rates include  
  
  
A. today's exchange rate.  
  
B. current forward exchange rates (e.g. the six-month forward rate is a pretty good predictor of the spot rate that will prevail six months from today).  
  
C. esoteric fundamental models that take an econometrician to use and no one can explain.  
  
D. both a and b

D. both a and b

Which of the following is a true statement?  
  
  
A. While researchers found it difficult to reject the random walk hypothesis for exchange rates on empirical grounds, there is no theoretical reason why exchange rates should follow a pure random walk.  
  
B. While researchers found it easy to reject the random walk hypothesis for exchange rates on empirical grounds, there are strong theoretical reasons why exchange rates should follow a pure random walk.  
  
C. While researchers found it difficult to reject the random walk hypothesis for exchange rates on empirical grounds, there are compelling theoretical reasons why exchange rates should follow a pure random walk.  
  
D. None of the above

A. While researchers found it difficult to reject the random walk hypothesis for exchange rates on empirical grounds, there is no theoretical reason why exchange rates should follow a pure random walk.

If the exchange rate follows a random walk  
  
  
A. the future exchange rate is unpredictable.  
  
B. the future exchange rate is expected to be the same as the current exchange rate, St = E(St + 1).  
  
C. the best predictor of future exchange rates is the forward rate Ft = E(St + 1|It).  
  
D. both b and c

B. the future exchange rate is expected to be the same as the current exchange rate, St = E(St + 1).

One implication of the random walk hypothesis is  
  
  
A. given the efficiency of foreign exchange markets, it is difficult to outperform the market-based forecasts unless the forecaster has access to private information that is not yet reflected in the current exchange rate.  
  
B. given the efficiency of foreign exchange markets, it is difficult to outperform the market-based forecasts unless the forecaster has access to private information that is already reflected in the current exchange rate.  
  
C. given the relative inefficiency of foreign exchange markets, it is difficult to outperform the technical forecasts unless the forecaster has access to private information that is not yet reflected in the current futures exchange rate.  
  
D. none of the above

A. given the efficiency of foreign exchange markets, it is difficult to outperform the market-based forecasts unless the forecaster has access to private information that is not yet reflected in the current exchange rate.

The random walk hypothesis suggests that  
  
  
A. the best predictor of the future exchange rate is the current exchange rate.  
  
B. the best predictor of the future exchange rate is the current forward rate.  
  
C. both a and b are consistent with the efficient market hypothesis.  
  
D. None of the above

A. the best predictor of the future exchange rate is the current exchange rate.

With regard to fundamental forecasting versus technical forecasting of exchange rates  
  
  
A. the technicians tend to use "cause and effect" models.  
  
B. the fundamentalists tend to believe that "history will repeat itself" is the best model.  
  
C. both a and b  
  
D. none of the above

D. none of the above

Generating exchange rate forecasts with the fundamental approach involves  
  
  
A. looking at charts of the exchange rate and extrapolating the patterns into the future  
  
B. estimation of a structural model  
  
C. substituting the estimated values of the independent variables into the estimated structural model to generate the forecast  
  
D. both b and c

D. both b and c

Which of the following issues are difficulties for the fundamental approach to exchange rate forecasting?  
  
  
A. One has to forecast a set of independent variables to forecast the exchange rates. Forecasting the former will certainly be subject to errors and may not be necessarily easier than forecasting the latter.  
  
B. The parameter values, that is the α's and β's, that are estimated using historical data may change over time because of changes in government policies and/or the underlying structure of the economy. Either difficulty can diminish the accuracy of forecasts even if the model is correct.  
  
C. The model itself can be wrong.  
  
D. All of the above

D. All of the above

Researchers have found that the fundamental approach to exchange rate forecasting  
  
  
A. outperforms the efficient market approach.  
  
B. fails to more accurately forecast exchange rates than either the random walk model or the forward rate model.  
  
C. fails to more accurately forecast exchange rates than the random walk model but is better than the forward rate model.  
  
D. outperforms the random walk model, but fails to more accurately forecast exchange rates than the forward rate model.

B. fails to more accurately forecast exchange rates than either the random walk model or the forward rate model.

Academic studies tend to discredit the validity of technical analysis. Which of the following is true?  
  
  
A. This can be viewed as support technical analysis.  
  
B. It can be rational for individual traders to use technical analysis—if enough traders use technical analysis the predictions based on it can become self-fulfilling to some extent, at least in the short-run.  
  
C. That can be explained by the difficulty professors may have in differentiating between technical analysis and fundamental analysis.  
  
D. None of the above

B. It can be rational for individual traders to use technical analysis—if enough traders use technical analysis the predictions based on it can become self-fulfilling to some extent, at least in the short-run.

The moving average crossover rule  
  
  
A. is a fundamental approach to forecasting exchange rates.  
  
B. states that a crossover of the short-term moving average above the long-term moving average signals that the foreign currency is appreciating.  
  
C. states that a crossover of the short-term moving average above the long-term moving average signals that the foreign currency is depreciating.  
  
D. none of the above

B. states that a crossover of the short-term moving average above the long-term moving average signals that the foreign currency is appreciating.

According to the technical approach, what matters in exchange rate determination  
  
  
A. the past behavior of exchange rates.  
  
B. the velocity of money.  
  
C. the future behavior of exchange rates.  
  
D. the beta.

A. the past behavior of exchange rates.

Studies of the accuracy of paid exchange rate forecasters  
  
  
A. tend to support the view that "you get what you pay for".  
  
B. tend to support the view that forecasting is easy, at least with regard to major currencies like the euro and Japanese yen.  
  
C. tend to support the view that banks do their best forecasting with the yen.  
  
D. none of the above

D. none of the above

According to the research in the accuracy of paid exchange rate forecasters,  
  
  
A. as a group, they do not do a better job of forecasting the exchange rate than the forward rate does.  
  
B. the average forecaster is better than average at forecasting.  
  
C. the forecasters do a better job of predicting the future exchange rate than the market does.  
  
D. none of the above

A. as a group, they do not do a better job of forecasting the exchange rate than the forward rate does.

According to the research in the accuracy of paid exchange rate forecasters,  
  
  
A. you can make more money selling forecasts than you can following forecasts.  
  
B. the average forecaster is better than average at forecasting.  
  
C. the forecasters do a better job of predicting the future exchange rates than the market does.  
  
D. none of the above.

A. you can make more money selling forecasts than you can following forecasts.

According to the monetary approach, what matters in exchange rate determination are  
  
  
A. the relative money supplies.  
  
B. the relative velocities of monies.  
  
C. the relative national outputs.  
  
D. all of the above

D. all of the above

According to the monetary approach, the exchange rate can be expressed as  
  
  
A. .  
  
B. .  
  
C. .  
  
D. none of the above.

A. .

**CHAP 7**

A CME contract on €125,000 with September delivery  
A. is an example of a forward contract.  
B. is an example of a futures contract.  
C. is an example of a put option.  
D. is an example of a call option.

B. is an example of a futures contract.

Yesterday, you entered into a futures contract to buy €62,500 at $1.50 per €. Suppose the futures price closes today at $1.46. How much have you made/lost?  
A. Depends on your margin balance.  
B. You have made $2,500.00.  
C. You have lost $2,500.00.  
D. You have neither made nor lost money, y

C. You have lost $2,500.00.

In reference to the futures market, a "speculator"  
A. attempts to profit from a change in the futures price  
B. wants to avoid price variation by locking in a purchase price of the underlying asset through a long position in the futures contract or a sales price through a short position in the futures contract  
C. stands ready to buy or sell contracts in unlimited quantity  
D. both b) and c)

A. attempts to profit from a change in the futures price

Comparing "forward" and "futures" exchange contracts, we can say that  
A. they are both "marked-to-market" daily.  
B. their major difference is in the way the underlying asset is priced for future purchase or sale: futures settle daily and forwards settle at maturity.  
C. a futures contract is negotiated by open outcry between floor brokers or traders and is traded on organized exchanges, while forward contract is tailor-made by an international bank for its clients and is traded OTC.  
D. both b) and c)

D. both b) and c)

Comparing "forward" and "futures" exchange contracts, we can say that  
A. delivery of the underlying asset is seldom made in futures contracts.  
B. delivery of the underlying asset is usually made in forward contracts.  
C. delivery of the underlying asset is seldom made in either contract—they are typically cash  
settled at maturity.  
D. both a) and b)  
E. both a) and c)

D. both a) and b)

In which market does a clearinghouse serve as a third party to all transactions?  
A. Futures  
B. Forwards  
C. Swaps  
D. None of the above

A. Futures

In the event of a default on one side of a futures trade,  
A. the clearing member stands in for the defaulting party.  
B. the clearing member will seek restitution for the defaulting party.  
C. if the default is on the short side, a randomly selected long contract will not get paid. That  
party will then have standing to initiate a civil suit against the defaulting short.  
D. both a) and b)

D. both a) and b)

Yesterday, you entered into a futures contract to buy €62,500 at $1.50 per €. Your initial performance bond is $1,500 and your maintenance level is $500. At what settle price will you get a demand for additional funds to be posted?  
A. $1.5160 per €.  
B. $1.208 per €.  
C. $1.1920 per €.  
D. $1.4840 per €

D. $1.4840 per €

Yesterday, you entered into a futures contract to sell €62,500 at $1.50 per €. Your initial performance bond is $1,500 and your maintenance level is $500. At what settle price will you get a demand for additional funds to be posted?  
A. $1.5160 per €.  
B. $1.208 per €.  
C. $1.1920 per €.  
D. $1.1840 per €

A. $1.5160 per €.

Yesterday, you entered into a futures contract to buy €62,500 at $1.50/€. Your initial margin was $3,750 (= 0.04 x €62,500 x $1.50/€ = 4 percent of the contract value in dollars). Your maintenance margin is $2,000 (meaning that your broker leaves you alone until your  
account balance falls to $2,000). At what settle price (use 4 decimal places) do you get a margin call?  
A. $1.4720/€  
B. $1.5280/€  
C. $1.500/€  
D. None of the above

A. $1.4720/€

Three days ago, you entered into a futures contract to sell €62,500 at $1.50 per €. Over the past three days the contract has settled at $1.50, $1.52, and $1.54. How much have you made or lost?  
A. Lost $0.04 per € or $2,500  
B. Made $0.04 per € or $2,500  
C. Lost $0.06 per € or $3,750  
D. None of the above

A. Lost $0.04 per € or $2,500

Today's settlement price on a Chicago Mercantile Exchange (CME) Yen futures contract is $0.8011/¥100. Your margin account currently has a balance of $2,000. The next three days' settlement prices are $0.8057/¥100, $0.7996/¥100, and $0.7985/¥100. (The contractual size of one CME Yen contract is ¥12,500,000). If you have a short position in one futures contract, the changes in the margin account from daily marking-to-market will result in the balance of the margin account after the third day to be  
A. $1,425.  
B. $2,000.  
C. $2,325.  
D. $3,425.

C. $2,325.

Today's settlement price on a Chicago Mercantile Exchange (CME) Yen futures contract is $0.8011/¥100. Your margin account currently has a balance of $2,000. The next three days' settlement prices are $0.8057/¥100, $0.7996/¥100, and $0.7985/¥100. (The contractual size of one CME Yen contract is ¥12,500,000). If you have a long position in one futures contract, the changes in the margin account from daily marking-to-market, will result in the balance of the margin account after the third day to be  
A. $1,425.  
B. $1,675.  
C. $2,000.  
D. $3,425.

B. $1,675.

Suppose the futures price is below the price predicted by IRP. What steps would assure an arbitrage profit?  
A. Go short in the spot market, go long in the futures contract.  
B. Go long in the spot market, go short in the futures contract.  
C. Go short in the spot market, go short in the futures contract.  
D. Go long in the spot market, go long in the futures contract.

A. Go short in the spot market, go long in the futures contract.

What paradigm is used to define the futures price?  
A. IRP  
B. Hedge Ratio  
C. Black Scholes  
D. Risk Neutral Valuation

A. IRP

If a currency futures contract (direct quote) is priced below the price implied by Interest Rate Parity (IRP), arbitrageurs could take advantage of the mispricing by simultaneously  
A. going short in the futures contract, borrowing in the domestic currency, and going long in the foreign currency in the spot market.  
B. going short in the futures contract, lending in the domestic currency, and going long in the foreign currency in the spot market.  
C. going long in the futures contract, borrowing in the domestic currency, and going short in the foreign currency in the spot market.  
D. going long in the futures contract, borrowing in the foreign currency, and going long in the domestic currency, investing the proceeds at the local rate of interest.

D. going long in the futures contract, borrowing in the foreign currency, and going long in the domestic currency, investing the proceeds at the local rate of interest.

Open interest in currency futures contracts  
A. tends to be greatest for the near-term contracts.  
B. tends to be greatest for the longer-term contracts.  
C. typically decreases with the term to maturity of most futures contracts.  
D. both a) and c)

D. both a) and c)

The "open interest" shown in currency futures quotations is  
A. the total number of people indicating interest in buying the contracts in the near future.  
B. the total number of people indicating interest in selling the contracts in the near future.  
C. the total number of people indicating interest in buying or selling the contracts in the near future.  
D. the total number of long or short contracts outstanding for the particular delivery month.

D. the total number of long or short contracts outstanding for the particular delivery month.

If you think that the dollar is going to appreciate against the euro, you should  
A. buy put options on the euro.  
B. sell call options on the euro.  
C. buy call options on the euro.  
D. none of the above

C. buy call options on the euro.

From the perspective of the writer of a put option written on €62,500. If the strike price is $1.55/€, and the option premium is $1,875, at what exchange rate do you start to lose money?  
A. $1.52/€  
B. $1.55/€  
C. $1.58/€  
D. None of the above

A. $1.52/€

A European option is different from an American option in that  
A. one is traded in Europe and one in traded in the United States.  
B. European options can only be exercised at maturity; American options can be exercised prior to maturity.  
C. European options tend to be worth more than American options, ceteris paribus.  
D. American options have a fixed exercise price; European options' exercise price is set at the average price of the underlying asset during the life of the option.

B. European options can only be exercised at maturity; American options can be exercised prior to maturity.

An "option" is  
A. a contract giving the seller (writer) of the option the right, but not the obligation, to buy (call) or sell (put) a given quantity of an asset at a specified price at some time in the future.  
B. a contract giving the owner (buyer) of the option the right, but not the obligation, to buy (call) or sell (put) a given quantity of an asset at a specified price at some time in the future.  
C. a contract giving the owner (buyer) of the option the right, but not the obligation, to buy (put) or sell (call) a given quantity of an asset at a specified price at some time in the future.  
D. a contract giving the owner (buyer) of the option the right, but not the obligation, to buy (put) or sell (sell) a given quantity of an asset at a specified price at some time in the future.

B. a contract giving the owner (buyer) of the option the right, but not the obligation, to buy (call) or sell (put) a given quantity of an asset at a specified price at some time in the future.

An investor believes that the price of a stock, say IBM's shares, will increase in the next 60 days. If the investor is correct, which combination of the following investment strategies will show a profit in all the choices?  
(i) - buy the stock and hold it for 60 days  
(ii) - buy a put option  
(iii) - sell (write) a call option  
(iv) - buy a call option  
(v) - sell (write) a put option  
  
A. (i), (ii), and (iii)  
B. (i), (ii), and (iv)  
C. (i), (iv), and (v)  
D. (ii) and (iii)

C. (i), (iv), and (v)

Most exchange traded currency options  
A. mature every month, with daily resettlement.  
B. have original maturities of 1, 2, and 3 years.  
C. have original maturities of 3, 6, 9, and 12 months.  
D. mature every month, without daily resettlement.

C. have original maturities of 3, 6, 9, and 12 months.

The volume of OTC currency options trading is  
A. much smaller than that of organized-exchange currency option trading.  
B. much larger than that of organized-exchange currency option trading.  
C. larger, because the exchanges are only repackaging OTC options for their customers.  
D. none of the above

B. much larger than that of organized-exchange currency option trading.

With currency futures options the underlying asset is  
A. foreign currency.  
B. a call or put option written on foreign currency.  
C. a futures contract on the foreign currency.  
D. none of the above

C. a futures contract on the foreign currency.

Exercise of a currency futures option results in  
A. a long futures position for the call buyer or put writer.  
B. a short futures position for the call buyer or put writer.  
C. a long futures position for the put buyer or call writer.  
D. a short futures position for the call buyer or put buyer.

A. a long futures position for the call buyer or put writer.

A currency futures option amounts to a derivative on a derivative. Why would something like that exist?  
A. For some assets, the futures contract can have lower transactions costs and greater liquidity than the underlying asset.  
B. Tax consequences matter as well, and for some users an option contract on a future is more tax efficient.  
C. Transactions costs and liquidity.  
D. All of the above

D. All of the above

The current spot exchange rate is $1.55 = €1.00 and the three-month forward rate is $1.60 = €1.00. Consider a three-month American call option on €62,500. For this option to be considered at-the-money, the strike price must be  
A. $1.60 = €1.00  
B. $1.55 = €1.00  
C. $1.55 x (1+i$)^3/12 = €1.00 x (1+i€)^3/12  
D. none of the above

B. $1.55 = €1.00

The current spot exchange rate is $1.55 = €1.00 and the three-month forward rate is $1.60 = €1.00. Consider a three-month American call option on €62,500 with a strike price of $1.50 = €1.00. Immediate exercise of this option will generate a profit of  
A. $6,125  
B. $6,125/(1+i$)3/12  
C. negative profit, so exercise would not occur  
D. $3,125

D. $3,125

The current spot exchange rate is $1.55 = €1.00 and the three-month forward rate is $1.60 = €1.00. Consider a three-month American call option on €62,500 with a strike price of $1.50 = €1.00. If you pay an option premium of $5,000 to buy this call, at what exchange rate will you break-even?  
A. $1.58 = €1.00  
B. $1.62 = €1.00  
C. $1.50 = €1.00  
D. $1.68 = €1.00

A. $1.58 = €1.00

The current spot exchange rate is $1.55 = €1.00; the three-month U.S. dollar interest rate is 2%. Consider a three-month American call option on €62,500 with a strike price of $1.50 = €1.00. What is the least that this option should sell for?  
A. $0.05 x 62,500 = $3,125  
B. $3,125/1.02 = $3,063.73  
C. $0.00  
D. none of the above

A. $0.05 x 62,500 = $3,125

Which of the follow options strategies are consistent in their belief about the future behavior of the underlying asset price?  
A. Selling calls and selling puts  
B. Buying calls and buying puts  
C. Buying calls and selling puts  
D. None of the above

C. Buying calls and selling puts

American call and put premiums  
A. should be at least as large as their intrinsic value.  
B. should be at no larger than their moneyness.  
C. should be exactly equal to their time value.  
D. should be no larger than their speculative value.

A. should be at least as large as their intrinsic value.

Which of the following is correct?  
A. Time value = intrinsic value + option premium  
B. Intrinsic value = option premium + time value  
C. Option premium = intrinsic value - time value  
D. Option premium = intrinsic value + time value

D. Option premium = intrinsic value + time value

Which of the following is correct?  
A. European options can be exercised early.  
B. American options can be exercised early.  
C. Asian options can be exercised early.  
D. All of the above

B. American options can be exercised early.

For European options, what of the effect of an increase in St?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

D. Increase the value of calls, decrease the value of puts ceteris paribus

For European currency options written on euro with a strike price in dollars, what of the effect of an increase in r$ relative to r€?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

D. Increase the value of calls, decrease the value of puts ceteris paribus

For European currency options written on euro with a strike price in dollars, what of the effect of an increase in r$?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

D. Increase the value of calls, decrease the value of puts ceteris paribus

For European currency options written on euro with a strike price in dollars, what of the effect of an increase r€?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

C. Decrease the value of calls, increase the value of puts ceteris paribus

For European currency options written on euro with a strike price in dollars, what of the effect of an increase in the exchange rate S($/€)?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

D. Increase the value of calls, decrease the value of puts ceteris paribus

For European currency options written on euro with a strike price in dollars, what of the effect of an increase in the exchange rate S(€/$)?  
A. Decrease the value of calls and puts ceteris paribus  
B. Increase the value of calls and puts ceteris paribus  
C. Decrease the value of calls, increase the value of puts ceteris paribus  
D. Increase the value of calls, decrease the value of puts ceteris paribus

C. Decrease the value of calls, increase the value of puts ceteris paribus

The hedge ratio  
A. Is the size of the long (short) position the investor must have in the underlying asset per option the investor must write (buy) to have a risk-free offsetting investment that will result in the investor perfectly hedging the option.  
B. <Formula>  
C. Is related to the number of options that an investor can write without unlimited loss while  
holding a certain amount of the underlying asset.  
D. All of the above

D. All of the above

Use the binomial option pricing model to find the value of a call option on £10,000 with a strike price of €12,500. The current exchange rate is €1.50/£1.00 and in the next period the exchange rate can increase  
to €2.40/£ or decrease to €0.9375/€1.00 (i.e. u = 1.6 and d = 1/u = 0.625). The current interest rates are i€ = 3% and are i£ = 4%.  
Choose the answer closest to yours.  
A. €3,275  
B. €2,500  
C. €3,373  
D. €3,243

A. €3,275

Find the hedge ratio for a call option on £10,000 with a strike price of €12,500. The current exchange rate is €1.50/£1.00 and in the next period the exchange rate can increase to €2.40/£ or decrease to €0.9375/€1.00 (i.e. u = 1.6 and d = 1/u = 0.625). The current interest rates are i€ = 3% and are i£ = 4%.  
Choose the answer closest to yours.  
A. 5/9  
B. 8/13  
C. 2/3  
D. 3/8  
E. None of the above

B. 8/13

You have written a call option on £10,000 with a strike price of $20,000. The current exchange rate is $2.00/£1.00 and in the next period the exchange rate can increase to $4.00/£1.00 or decrease to $1.00/€1.00 (i.e. u = 2 and d = 1/u = 0. 5). The current interest rates are i$ = 3% and are i£ = 2%. Find the hedge ratio and use it to create a position in the underlying asset that will hedge your option position.  
  
A. Buy £10,000 today at $2.00/£1.00.  
B. Enter into a short position in a futures contract on £6,666.67.  
C. Lend the present value of £6,666.67 today at i£ = 2%.  
D. Enter into a long position in a futures contract on £6,666.67.  
E. Both c) and d) would work  
F. None of the above

E. Both c) and d) would work

Find the hedge ratio for a put option on $15,000 with a strike price of €10,000. In one period the exchange rate (currently S($/€) = $1.50/€) can increase by 60% or decrease by 37.5% (i.e. u = 1.6 and d = 0.625).  
A. -15/49  
B. 5/13  
C. 3/2  
D. 15/49

A. -15/49

Find the hedge ratio for a put option on €10,000 with a strike price of $15,000. In one period the exchange rate (currently S($/€) = $1.50/€) can increase by 60% or decrease by 37.5% (i.e. u = 1.6 and d = 0.625).  
A. -15/49  
B. 8/13  
C. -5/13  
D. 15/49

C. -5/13

Find the dollar value today of a 1-period at-the-money call option on €10,000. The spot exchange rate is €1.00 = $1.25. In the next period, the euro can increase in dollar value to $2.00 or fall to $1.00. The interest rate in dollars is i$ = 27.50%; the interest rate in euro is i€ = 2%.  
A. $3,308.82  
B. $0  
C. $3,294.12  
D. $4,218.75

A. $3,308.82

Suppose that you have written a call option on €10,000 with a strike price in dollars. Suppose further that the hedge ratio is ½. Which of the following would be an appropriate hedge for a short position in this call option?  
A. Buy €10,000 today at today's spot exchange rate.  
B. Buy €5,000 today at today's spot exchange rate.  
C. Agree to buy €5,000 at the maturity of the option at the forward exchange rate for the maturity of the option that prevails today (i.e., go long in a forward contract on €5,000).  
D. Buy the present value of €5,000 discounted at i€ for the maturity of the option.  
E. Both c) and d) would work.  
F. None of the above

E. Both c) and d) would work.

Find the value of a one-year put option on $15,000 with a strike price of €10,000. In one year the exchange rate (currently S0($/€) = $1.50/€) can increase by 60% or decrease by 37.5% (i.e. u = 1.6 and d = 0.625). The current one-year interest rate in the U.S. is i$ = 4% and the current one-year interest rate in the euro zone is i€ = 4%.  
A. €1,525.52  
B. $3,328.40  
C. $4,992.60  
D. €2,218.94  
E. None of the above

D. €2,218.94

Find the value of a one-year call option on €10,000 with a strike price of $15,000. In one year the exchange rate (currently S0($/€) = $1.50/€) can increase by 60% or decrease by 37.5% (i.e. u = 1.6 and d = 0.625). The current one-year interest rate in the U.S. is i$ = 4% and the current one-year interest rate in the euro zone is i€ = 4%.  
A. €1,525.52  
B. $3,328.40  
C. $4,992.60  
D. €2,218.94  
E. None of the above

B. $3,328.40

Consider a 1-year call option written on £10,000 with an exercise price of $2.00 = £1.00. The current exchange rate is $2.00 = £1.00; The U.S. risk-free rate is 5% over the period and the U.K. risk-free rate is also 5%. In the next year, the pound will either double in dollar terms or fall by half (i.e. u = 2 and d = ½). If you write 1 call option, what is the value today (in dollars) of the hedge portfolio?  
A. £6,666.67  
B. £6,349.21  
C. $12,698.41  
D. $20,000  
E. None of the above

C. $12,698.41

Which of the following is correct?  
A. The value (in dollars) of a call option on £5,000 with a strike price of $10,000 is equal to the value (in dollars) of a put option on $10,000 with a strike price of £5,000 only when the spot exchange rate is $2 = £1.  
B. The value (in dollars) of a call option on £5,000 with a strike price of $10,000 is equal to the value (in dollars) of a put option on $10,000 with a strike price of £5,000.

B. The value (in dollars) of a call option on £5,000 with a strike price of $10,000 is equal to the value (in dollars) of a put option on $10,000 with a strike price of £5,000.

**CHAP 4**

Corporate governance can be defined as:  
  
A. the economic, legal, and institutional framework in which corporate control and cash flow rights are distributed among shareholders, managers and other stakeholders of the company.  
  
B. the general framework in which company management is selected and monitored.  
  
C. the rules and regulations adopted by boards of directors specifying how to manage companies.  
  
D. the government-imposed rules and regulations affecting corporate management.

A

When managerial self-dealings are excessive and left unchecked,  
  
A. they can have serious negative effects on share values.  
  
B. they can impede the proper functions of capital markets.  
  
C. they can impede such measures as GDP growth.  
  
D. all of the above

D

The genius of public corporations stems from their capacity to allow efficient sharing or spreading of risk among many investors, who can buy and sell their ownership shares on liquid stock exchanges and let professional managers run the company on behalf of shareholders. This risk sharing stems from  
  
A. the liquidity of the shares.  
  
B. the limited liability of shareholders.  
  
C. the limited liability of bondholders.  
  
D. the limited ability of shareholders.

B

The key weakness of the public corporation is  
  
  
A. too many shareholders, which makes it difficult to make corporate decisions.  
  
B. relatively high corporate income tax rates.  
  
C. conflicts of interest between managers and shareholders.  
  
D. conflicts of interests between shareholders and bondholders.

C

When company ownership is diffuse,  
  
  
A. a "free rider" problem discourages shareholder activism.  
  
B. the large number of shareholders ensures strong monitoring of managerial behavior because with a large enough group, there's almost always someone who will incur the costs of monitoring management.  
  
C. few shareholders have a strong enough incentive to incur the costs of monitoring management.  
  
D. both a and c are correct

D

In many countries with concentrated ownership  
  
  
A. the conflicts of interest between shareholders and managers are worse than in countries with diffuse ownership of firms.  
  
B. the conflicts of interest are greater between large controlling shareholders and small outside shareholders than between managers and shareholders.  
  
C. the conflicts of interest are greater between managers and shareholders than between large controlling shareholders and small outside shareholders.  
  
D. corporate forms of business organization with concentrated ownership are rare.

B

The central issue of corporate governance is  
  
A. how to protect creditors from managers and controlling shareholders.  
  
B. how to protect outside investors from the controlling insiders.  
  
C. how to alleviate the conflicts of interest between managers and shareholders.  
  
D. how to alleviate the conflicts of interest between shareholders and bondholders.

B

The strongest protection for investors is provided by  
  
A. English common law countries, such as Canada, the United States, and the U.K.  
  
B. French civil law countries, such as Belgium, Italy, and Mexico.  
  
C. a weak board of directors.  
  
D. socialized firms.

A

The separation of the company's ownership and control,  
  
  
A. is especially prevalent in such countries as the United States and the United Kingdom, where corporate ownership is highly diffused.  
  
B. is especially prevalent in such countries as the Italy and Mexico, where corporate ownership is highly concentrated.  
  
C. is a rational response to the agency problem.  
  
D. none of the above

A

Outside the United States and the United Kingdom,  
  
  
A. concentrated ownership of the company is more the exception than the rule.  
  
B. diffused ownership of the company is more the exception than the rule.  
  
C. partnerships are more important than corporations.  
  
D. none of the above

B

A complete contract between shareholders and managers  
  
  
A. would specify exactly what the manager will do under each of all possible future contingencies.  
  
B. would be an expensive contract to write and a very expensive contract to monitor.  
  
C. would eliminate any conflicts of interest (and managerial discretion).  
  
D. all of the above

D

Free cash flow refers to  
  
  
A. a firm's cash reserve in excess of tax obligation.  
  
B. a firm's funds in excess of what's needed for undertaking all profitable projects.  
  
C. a firm's cash reserve in excess of interest and tax payments.  
  
D. a firm's income tax refund that is due to interest payments on borrowing.

B

Why do managers tend to retain free cash flow?  
  
  
A. Managers are in the best position to decide the best use of those funds.  
  
B. These funds are needed for undertaking profitable projects and the issue costs are less than new issues of stocks or bonds.  
  
C. Managers may not be acting in the shareholders best interest, and for a variety of reasons, want to use the free cash flow.  
  
D. None of the above

C

The agency problem tends  
  
  
A. to be more serious in firms with free cash flows.  
  
B. to be more serious in firms with excessive amounts of excess cash.  
  
C. to be less serious in firms with few numbers of shareholders.  
  
D. all of the above

D

It is important for society as a whole to solve the agency problem, since the agency problem  
  
  
A. leads to waste of scarce resources.  
  
B. hampers capital market functions.  
  
C. retards economic growth.  
  
D. all of the above

D

In the U.S., the chief role of the board of directors is  
  
  
A. to hire the management team.  
  
B. to decide on the annual capital budget.  
  
C. to design an effective incentive compatible compensation scheme for themselves.  
  
D. none of the above

A

In Germany the corporate board is  
  
  
A. legally charged with representing the interests of shareholders exclusively.  
  
B. legally charged with looking after the interests of stakeholders (e.g., workers, creditors, etc.) in general, not just shareholders.  
  
C. legally charged as a supervisory board only.  
  
D. legally charged as a management board only.

B

In the United States, it is not uncommon for the same person to serve as both CEO and chairman of the board.  
  
  
A. This situation must not have much conflict of interest since it is common.  
  
B. This situation has a built-in conflict of interest.  
  
C. This is only legal if that individual owns a controlling number of shares in the firm.  
  
D. None of the above

B

If an incentive contract specifies certain accounting performance  
  
  
A. that accounting number will likely be the focus of managers.  
  
B. managers will set aside the accounting goal if it conflicts with the goal of maximizing shareholder wealth.  
  
C. managers will be unable to manipulate the GAAP, so shareholders can be confident of having their wealth maximized.

A

Accounting Transparency  
  
  
A. can only be achieved when managers commit to serving on their own audit committee.  
  
B. occurs when the accounting department has translucent cubicles for their workers.  
  
C. promises to reduce the information asymmetry between corporate insiders and the public.  
  
D. none of the above

C

While debt can reduce agency costs between shareholders and management,  
  
  
A. excessive debt may also induce the risk-averse managers to forgo profitable but risky investment projects, causing an underinvestment problem.  
  
B. with debt financing companies can misuse debt to finance corporate empire building.  
  
C. both a and b  
  
D. none of the above

C

Benetton, an Italian clothier, is listed on the New York Stock Exchange.  
  
  
A. This decision provides their shareholders with a higher degree of protection than is available in Italy.  
  
B. This decision can be a signal of the company's commitment to shareholder rights.  
  
C. This may make investors both in Italy and abroad more willing to provide capital and to increase the value of the pre-existing shares.  
  
D. All of the above

D

Nâng cấp để gỡ bỏ quảng cáo

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In many countries, hostile takeovers are relatively rare. This is so partly because of  
  
  
A. the language barrier.  
  
B. concentrated ownership in these countries.  
  
C. cultural values and political environments disapproving hostile corporate takeovers.  
  
D. both b and c

D

Suppose Mr. Lee and his relatives hold 30% of shares outstanding of Samsung Life, which in turn holds 20% of Samsung Electronics. What is the cash flow right of the Lee family in Samsung Electronics?  
  
  
A. 50 percent  
  
B. 10 percent  
  
C. 20 percent  
  
D. 6 percent

D. 30% x 20% = 6%

A pyramidal ownership structure is one in which  
  
  
A. a shareholder controls a holding company that owns a controlling block of another company, which in turn owns controlling interests in yet another company, and so on.  
  
B. equity cross-holdings among a group of companies, such as keiretsu and chaebols can be used to concentrate and leverage voting rights to acquire control.  
  
C. a combination of these schemes may also be used to leverage control in a pyramidal ownership structure.

C

What is the difference between control rights and cash flow rights?  
  
  
A. Since all shareholders benefit only from pro-rata cash flows, control rights and cash flow rights are the same thing.  
  
B. Large investors may be able to derive private benefits from control, thus control rights can exceed cash flow rights.  
  
C. Cash flow rights are more important than control rights since the only reason to invest in anything is to generate cash.  
  
D. None of the above

B

The Sarbanes-Oxley Act of 2002 stipulates that  
  
  
A. a public accounting oversight board be created.  
  
B. the company should appoint independent financial experts to its audit committee.  
  
C. CEO and CFO sign off the company's financial statements.  
  
D. all of the above

D

The major components of the Sarbanes-Oxley Act are:  
  
  
A. accounting regulation—The creation of a public accounting oversight board charged with overseeing the auditing of public companies, and restricting the consulting services that auditors can provide to clients.  
  
B. audit committee—The company should appoint independent "financial experts" to its audit committee.  
  
C. internal control assessment—Public companies and their auditors should assess the effectiveness of internal control of financial record keeping and fraud prevention.  
  
D. executive responsibility—Chief executive and finance officers (CEO and CFO) must sign off on the company's quarterly and annual financial statements. If fraud causes an overstatement of earnings, these officers must return any bonuses.  
  
E. all of the above

E

The Cadbury Code of Best Practice  
  
  
A. is the U.N. equivalent of the Sarbanes-Oxley Act.  
  
B. is voluntary, but firms that fail to comply must explain why they choose not to comply.  
  
C. has the force of law, like the Sarbanes-Oxley Act.  
  
D. none of the above

B

The key requirements of the Cadbury Code of Best Practice state that  
  
  
A. boards of directors should include at least three outside directors.  
  
B. the positions of CEO and chairman of the board should not reside in the same individual.  
  
C. compliance is mandatory for public corporations, optional for listed non-public corporations.  
  
D. both a and b

D

1 Corporate governance can be defined as  
a) the economic, legal, and institutional framework in which corporate control and cash flow rights are distributed among shareholders, managers and other stakeholders of the company.  
b) the general framework in which company management is selected and monitored.  
c) the rules and regulations adopted by boards of directors specifying how to manage companies.  
d) the government-imposed rules and regulations affecting corporate management.

A

2 Corporate governance structure  
a) varies a great deal across countries.  
b) has become homogenized following the integration of capital markets.  
c) has become homogenized due to cross-listing of shares of many public corporations.  
d) none of the above

A

3 In a public company with diffused ownership, the board of directors is entrusted with  
a) monitoring the auditors and safeguarding the interests of shareholders.  
b) monitoring the shareholders and safeguarding the interests of management.  
c) monitoring the management and safeguarding the interests of shareholders.  
d) none of the above

C

4 The key weakness of the public corporation is  
a) too many shareholders, which makes it difficult to make corporate decision.  
b) relatively high corporate income tax rates.  
c) conflicts of interest between managers and shareholders.  
d) conflicts of interests between shareholders and bondholders.

C

5 When company ownership is diffuse,  
a) a "free rider" problem discourages shareholder activism.  
b) the large number of shareholders ensures strong monitoring of managerial behavior because with a large enough group, there's almost always someone who will to incur the costs of monitoring management.  
c) few shareholders have a strong enough incentive to incur the costs of monitoring management.  
d) both a) and c) are correct

D

6 In many countries with concentrated ownership  
a) the conflicts of interest between shareholders and managers are worse than in countries with diffuse ownership of firms.  
b) the conflicts of interest are greater between large controlling shareholders and small outside shareholders than between managers and shareholders.  
c) the conflicts of interest are greater between managers and shareholders than between large controlling shareholders and small outside shareholders.  
d) corporate forms of business organization with concentrated ownership are rare.

B

7 The public corporation  
a) is jointly owned by a (potentially) large number of shareholders.  
b) offers shareholders limited liability.  
c) separates the ownership and control of a firms assets.  
d) all of the above

D

8 The key strengths of the public corporation is/are  
a) their capacity to allow efficient risk sharing among many investors.  
b) their capacity to raise large amounts of funds at relatively low cost.  
c) their capacity to consolidate decision-making.  
d) all of the above

D

9 The central issue of corporate governance is  
a) how to protect creditors from managers and controlling shareholders.  
b) how to protect outside investors from the controlling insiders.  
c) how to alleviate the conflicts of interest between managers and shareholders.  
d) how to alleviate the conflicts of interest between shareholders and bondholders.

B

10 In theory,  
a) managers are hired by the shareholders at the annual stockholders meeting. If the managers turn in a bad year, new ones get hired.  
b) shareholders hire the managers to oversee the board of directors.  
c) managers are hired by the board of directors; the board is accountable to the shareholders.  
d) none of the above

C

11 In the reality of corporate governance at the turn of this century,  
a) boards of directors are often dominated by management-friendly insiders.  
b) a typical board of directors often has relatively few outside directors who can independently and objectively monitor the management.  
c) managers of one firm often sit on the boards of other firms, whose managers are on the board of the first firm. Due to the interlocking nature of these boards, there can exist a culture of "I'll overlook your problems if you overlook mine."  
d) all of the above have been true to a greater or lesser extent in the recent past.

D

12 The public corporation has a key weakness:  
a) the conflicts of interest between bondholders and shareholders.  
b) the conflicts of interest between managers and bondholders.  
c) the conflicts of interest between stakeholders and shareholders.  
d) the conflicts of interest between managers and shareholders.

D

13 The separation of the company's ownership and control,  
a) is especially prevalent in such countries as the United States and the United Kingdom, where corporate ownership is highly diffused.  
b) is especially prevalent in such countries as the Italy and Mexico, where corporate ownership is highly concentrated.  
c) is a rational response to the agency problem.  
d) none of the above

A

14 In the United States, managers are legally bound by the "duty of loyalty" to  
a) the board of directors.  
b) to the shareholders.  
c) to the bondholders.  
d) to the government.

B

15 Outside the United States and the United Kingdom,  
a) concentrated ownership of the company is more the exception than the rule.  
b) diffused ownership of the company is more the exception than the rule.  
c) partnerships are more important than corporations.  
d) none of the above

B

16 Why is it rational to make shareholders "weak" by giving control to the managers of the firm?  
a) This may be rational when shareholders may be neither qualified nor interested in making business decisions.  
b) This may be rational since many shareholders find it easier to sell their shares in an underperforming firm than to monitor the management.  
c) This may be rational to the extent that managers are answerable to the board of directors.  
d) All of the above are explanations for the separation of ownership and control.

D

17 The investors supply funds to the company but are not involved in the company's daily decision making. As a result, many public companies come to have  
a) strong shareholders and weak managers.  
b) strong managers and weak shareholders.  
c) strong managers and strong shareholders.  
d) weak managers and weak shareholders.

B

18 The agency problem refers to the possible conflicts of interest between  
a) self-interested managers as principals and shareholders of the firm who are the agents.  
b) altruistic managers as agents and shareholders of the firm who are the principals.  
c) self-interested managers as agents and shareholders of the firm who are the principals.  
d) dutiful managers as principals and shareholders of the firm who are the agents.

C

19 Self-interested managers may be tempted to  
a) indulge in expensive perquisites at company expense.  
b) adopt antitakeover measures for their company to ensure their personal job security.  
c) waste company funds by undertaking unprofitable projects that benefit themselves but not shareholders.  
d) all of the above are potential abuses that self-interested managers may be tempted to visit upon shareholders.

D

20 In the U.S., the chief role of the board of directors is  
a) to hire the management team.  
b) to decide on the annual capital budget.  
c) to design an effective incentive compatible compensation scheme for themselves.  
d) none of the above

A

21 In the United Kingdom, the majority of public companies  
a) voluntarily abide by the Code of Best Practice on corporate governance.  
b) are compelled by law to abide by the Code of Best Practice on corporate governance.  
c) do not abide by the Code of Best Practice on corporate governance.

A

22 In Germany the corporate board is  
a) legally charged with representing the interests of shareholders exclusively.  
b) legally charged with looking after the interests of stakeholders (e.g., workers, creditors, etc.) in general, not just shareholders.  
c) legally charged as a supervisory board only.  
d) legally charged as a management board only.

B

23 In the United States  
a) boards of directors are legally responsible for representing the interests of the shareholders.  
b) due to the diffused ownership structure of the public company, management often gets to choose board members who are likely to be friendly to management.  
c) there is a correlation between underperforming firms and boards of directors who are not fully independent.  
d) all of the above are true, in the United States.

D

24 In the United States, it is not uncommon for the same person to serve as both CEO and chairman of the board.  
a) This situation must not have much conflict of interest since it is common.  
b) This situation has a built-in conflict of interest.  
c) This is only legal if that individual owns a controlling number of shares in the firm  
d) None of the above

B

25 Concentrated ownership of a public company  
a) can be an effective way to alleviate the agency problem between shareholders and managers.  
b) is the norm in Great Britain.  
c) tends to be an ineffective way to alleviate conflicts of interest between groups of shareholders.  
d) none of the above

A

26 While debt can reduce agency costs between shareholders and management,  
a) excessive debt may also induce the risk-averse managers to forgo profitable but risky investment projects, causing an underinvestment problem.  
b) with debt financing companies can misuse debt to finance corporate empire building.  
c) both a) and b)  
d) none of the above

C

27 In the United States and the United Kingdom, hostile takeovers  
a) are illegal.  
b) can serve as a drastic corporate governance mechanism of the last resort.  
c) reinforce the notion that managers can take their control of the company for granted.  
d) require management approval.

B

28 English common law countries tend to provide a stronger protection of shareholder rights than French civil law countries because  
a) the former countries tend to be more democratic than the latter.  
b) the former countries tend to protect property rights better than the latter.  
c) the former countries tend to have more separation of power than the latter.  
d) all of the above

B

29 Many companies issue shares with differential voting rights, deviating from the one-share one-vote principle.  
a) By accumulating superior voting shares, investors can acquire cash flow rights exceeding control rights.  
b) The price of the voting shares is usually twice the price of the voting shares.  
c) By accumulating superior voting shares, investors can acquire control rights exceeding cash flow rights.  
d) None of the above

C

30 A pyramidal ownership structure is one in which  
a) a shareholder controls a holding company that owns a controlling block of another company, which in turn owns controlling interests in yet another company, and so on.  
b) equity cross-holdings among a group of companies, such as keiretsu and chaebols can be used to concentrate and leverage voting rights to acquire control.  
c) a combination of these schemes may also be used to leverage control in a pyramidal ownership structure

C

31 One of the objectives of corporate governance reform is to,  
a) introduce expensive and burdensome accounting reforms.  
b) strengthen the protection of outside investors from expropriation by managers and controlling insiders.  
c) provide taxpayer financing for corporate raiders to strengthen the discipline of the marketplace.  
d) none of the above

B

32 The Sarbanes-Oxley Act of 2002 stipulates that  
a) a public accounting oversight board be created.  
b) the company should appoint independent financial experts to its audit committee.  
c) CEO and CFO sign off the company's financial statements.  
d) all of the above

D

33 The Sarbanes-Oxley Act of 2002  
a) applies to all U.S. firms  
b) applies to listed companies  
c) applies to issuers whose securities are traded on an over-the-counter bulletin board.  
d) all of the above

B

34 The Sarbanes-Oxley Act of 2002  
a) has had the consequence that many foreign firms have de-listed in the U.S. exchanges and listed their shares on the London Stock Exchange and other European exchanges.  
b) has increased the pace of foreign firms listing their shares in the U.S.  
c) a) and b) are both true  
d) all of the above

A

35 Since the passage of the Sarbanes-Oxley Act,  
a) some foreign firms choose to list their shares on the London Stock Exchange and other European exchanges, instead of U.S. exchanges, to avoid the costly compliance.  
b) the pace of foreign firms listing their shares in the U.S. has increased.  
c) the firms have passed this increased cost on to their customers.

A

36 The major components of the Sarbanes-Oxley Act include all of the following except  
a) accounting regulation—The creation of a public accounting oversight board charged with overseeing the auditing of public companies, and restricting the consulting services that auditors can provide to clients.  
b) audit committee—the company should appoint independent "financial experts" to its audit committee.  
c) shareholder voting rights reform—"one share one vote" is now the law of the land.  
d) executive responsibility—CEOs and CFOs must sign off on the company's financial statements.

C

37 The Cadbury Code of Best Practice  
a) is the U.N. equivalent of the Sarbanes-Oxley Act.  
b) is voluntary, but firms that fail to comply must explain why they choose not to comply.  
c) has the force of law, like the Sarbanes-Oxley Act.  
d) none of the above

B

38 The Cadbury Code has not been legislated into law, and compliance with the code is voluntary.  
a) However, the London Stock Exchange (LSE) currently requires that each listed company show whether the company is in compliance with the code and explain why if it is not.  
b) This "comply or explain" approach has apparently persuaded many companies to comply rather than explain.  
c) Currently, 90 percent of all LSE-listed companies have adopted the Cadbury Code.  
d) All of the above

D

39 Even though the compliance the Cadbury Code of Best Practice is voluntary,  
a) the Cadbury Code has made a significant impact on the internal governance mechanisms of U.K. companies.  
b) the job security of U.K. chief executives has become more sensitive to the company performance, strengthening managerial accountability and weakening its entrenchment.  
c) joint CEO/COB (chief executive officer and chairman of the board) positions declined.  
d) all of the above

D

40 The key requirements of the Cadbury Code of Best Practice state that  
a) boards of directors should include at least three outside directors.  
b) the positions of CEO and chairman of the board should not reside in the same individual.  
c) compliance is mandatory for public corporations, optional for listed non-public corporations.  
d) both a) and b)

D

**CHAP 8**

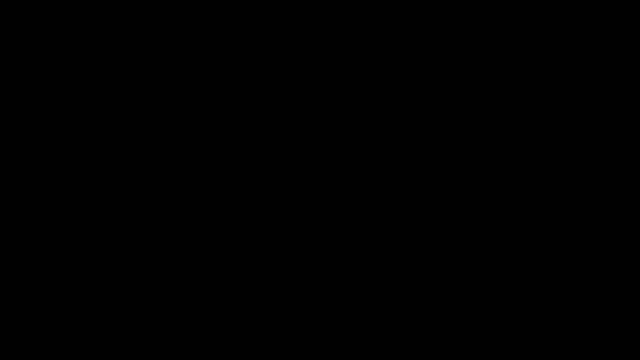
Transaction exposure is defined as  
  
  
A. the sensitivity of realized domestic currency values of the firm's contractual cash flows denominated in foreign currencies to unexpected exchange rate changes.  
  
B. the extent to which the value of the firm would be affected by unanticipated changes in exchange rate.  
  
C. the potential that the firm's consolidated financial statement can be affected by changes in exchange rates.  
  
D. ex post and ex ante currency exposures.

A. the sensitivity of realized domestic currency values of the firm's contractual cash flows denominated in foreign currencies to unexpected exchange rate changes.

The most direct and popular way of hedging transaction exposure is by  
  
  
A. exchange-traded futures options.  
  
B. currency forward contracts.  
  
C. foreign currency warrants.  
  
D. borrowing and lending in the domestic and foreign money markets.

B. currency forward contracts.

00:0201:08



If you have a long position in a foreign currency, you can hedge with:  
  
  
A. A short position in an exchange-traded futures option  
  
B. A short position in a currency forward contract  
  
C. A short position in foreign currency warrants  
  
D. Borrowing (not lending) in the domestic and foreign money markets

B. A short position in a currency forward contract

If you owe a foreign currency denominated debt, you can hedge with  
  
  
A. a long position in a currency forward contract.  
  
B. a long position in an exchange-traded futures option.  
  
C. buying the foreign currency today and investing it in the foreign county.  
  
D. both a and c

D. both a and c

If you own a foreign currency denominated bond, you can hedge with  
  
  
A. a long position in a currency forward contract.  
  
B. a long position in an exchange-traded futures option.  
  
C. buying the foreign currency today and investing it in the foreign county.  
  
D. a swap contract where pay the cash flows of the bond in exchange for dollars.

D. a swap contract where pay the cash flows of the bond in exchange for dollars.

The sensitivity of "realized" domestic currency values of the firm's contractual cash flows denominated in foreign currency to unexpected changes in the exchange rate is  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

A. transaction exposure.

The sensitivity of the firm's consolidated financial statements to unexpected changes in the exchange rate is  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

B. translation exposure.

The extent to which the value of the firm would be affected by unexpected changes in the exchange rate is  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

C. economic exposure.

With any hedge  
  
  
A. your losses on one side should about equal your gains on the other side.  
  
B. you should try to make money on both sides of the transaction: that way you make money coming and going.  
  
C. you should spend at least as much time working the hedge as working the underlying deal itself.  
  
D. you should agree to anything your banker puts in front of your face.

A. your losses on one side should about equal your gains on the other side.

With any successful hedge  
  
  
A. you are guaranteed to lose money on one side.  
  
B. you can avoid the accounting ramifications of a loss on one side by keeping it off the books.  
  
C. both a and b  
  
D. none of the above

D. none of the above

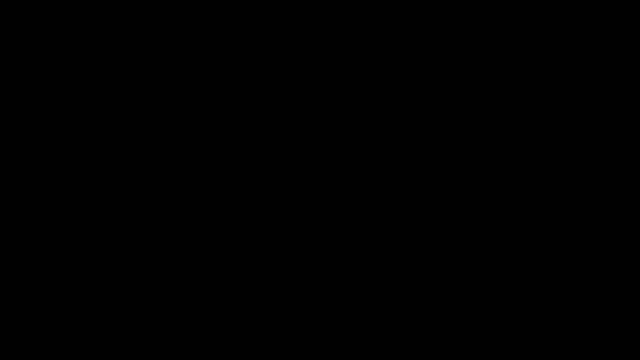
The choice between a forward market hedge and a money market hedge often comes down to  
  
  
A. interest rate parity.  
  
B. option pricing.  
  
C. flexibility and availability.  
  
D. none of the above

A. interest rate parity.

Since a corporation can hedge exchange rate exposure at low cost  
  
  
A. there is no benefit to the shareholders in an efficient market.  
  
B. shareholders would benefit from the risk reduction that hedging offers.  
  
C. the corporation's banker would benefit from the risk reduction that hedging offers.  
  
D. none of the above

C. the corporation's banker would benefit from the risk reduction that hedging offers.

00:0301:08



Nâng cấp để gỡ bỏ quảng cáo

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A CFO should be least worried about  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

B. translation exposure.

Exchange rate risk of a foreign currency payable is an example of  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

A. transaction exposure.

A stock market investor would pay attention to  
  
  
A. anticipated changes in exchange rates that have been already discounted and reflected in the firm's value.  
  
B. unanticipated changes in exchange rates that have not been discounted and reflected in the firm's value.

A. anticipated changes in exchange rates that have been already discounted and reflected in the firm's value.

16. Suppose that Boeing Corporation exported a Boeing 747 to Lufthansa and billed €10 million payable in one year. The money market interest rates and foreign exchange rates are given as follows:  
  
  
  
Assume that Boeing sells a currency forward contract of €10 million for delivery in one year, in exchange for a predetermined amount of U.S. dollar. Which of the following is (or are) true?  
On the maturity date of the contract Boeing will:  
  
(i) have to deliver €10 million to the bank (the counterparty of the forward contract)  
(ii) take delivery of $14.6 million  
(iii) have a zero net pound exposure  
(iv) have a profit, or a loss, depending on the future changes in the exchange rate, from this British sale  
  
  
A. (i) and (iv)  
  
B. (ii) and (iv)  
  
C. (ii), (iii), and (iv)  
  
D. (i), (ii), and (iii)

D. (i), (ii), and (iii)

Suppose that Boeing Corporation exported a Boeing 747 to Lufthansa and billed €10 million payable in one year. The money market interest rates and foreign exchange rates are given as follows:  
  
  
  
Assume that Boeing sells a currency forward contract of €10 million for delivery in one year, in exchange for a predetermined amount of U.S. dollars. Suppose that on the maturity date of the forward contract, the spot rate turns out to be $1.40/€ (i.e. less than the forward rate of $1.46/€). Which of the following is true?  
  
  
A. Boeing would have received only $14.0 million, rather than €14.6 million, had it not entered into the forward contract  
  
B. Boeing gained $0.6 million from forward hedging  
  
C. a and b  
  
D. none of the above

C. a and b

18. Your firm is a U.K.-based exporter of British bicycles. You have sold an order to an Italian firm for €1,000,000 worth of bicycles. Payment from the Italian firm (in €) is due in twelve months. Your firm wants to hedge the receivable into pounds. Not dollars. Use the following table for exchange rate data.  
  
  
  
Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type.  
  
  
A. Borrow €970,873.79 in one year you owe €1m, which will be financed with the receivable. Convert €970,873.79 to dollars at spot, receive $1.165.048,54. Convert dollars to pounds at spot, receive £728.155.34.  
  
B. Sell €1m forward using 16 contracts at $1.20 per €1. Buy £750,000 forward using 12 contracts at $1.60 per £1.  
  
C. Sell €1m forward using 16 contracts at the forward rate of $1.29 per €1.  
  
D. Sell €1m forward using 16 contracts at the forward rate of $1.29 per €1. Buy £750,000 forward using 12 contracts at the forward rate of $1.72 per £1.

D. Sell €1m forward using 16 contracts at the forward rate of $1.29 per €1. Buy £750,000 forward using 12 contracts at the forward rate of $1.72 per £1.

A Japanese EXPORTER has a €1,000,000 receivable due in one year. Spot and forward exchange rate data is given in the table:  
  
  
  
The one-year risk free rates are i$ = 4.03%; i€ = 6.05%; and i¥ = 1%. Detail a strategy using forward contracts that will hedge exchange rate risk.  
  
  
A. Borrow €970,873.79 today; in one year you owe €1m, which will be financed with the receivable. Convert €970,873.79 to dollars at spot, receive $1,165,048.54. Convert dollars to yen at spot, receive ¥116,504,854.  
  
B. Sell €1m forward using 16 contracts at the forward rate of $1.20 per €1. Buy ¥150,000,000 forward using 11.52 contracts, at the forward rate of $1.00 = ¥120.  
  
C. Sell €1m forward using 16 contracts at the forward rate of $1.25 per €1. Buy ¥150,000,000 forward using 12 contracts, at the forward rate of $1.00 = ¥120.  
  
D. None of the above

C. Sell €1m forward using 16 contracts at the forward rate of $1.25 per €1. Buy ¥150,000,000 forward using 12 contracts, at the forward rate of $1.00 = ¥120.

Your firm has a British customer that is willing to place a $1 million order, but wants to pay in pounds instead of dollars. The spot exchange rate is $1.85 = £1.00 and the one-year forward rate is $1.90 = £1.00. The lead time on the order is such that payment is due in one year. What is the fairest exchange rate to use?  
  
  
A. $1.85 = £1.00  
  
B. $1.8750 = £1.00  
  
C. $1.90 = £1.00  
  
D. none of the above

C. $1.90 = £1.00

Your firm has a British customer that is willing to place a $1 million order (with payment due in 6 months), but insists upon paying in pounds instead of dollars.  
  
  
A. The customer essentially wants you to discount your price by the value of a put option on pounds.  
  
B. The customer essentially wants you to discount your price by the value of a call option on pounds.  
  
C. None of the above

C. None of the above

Your firm is a U.K.-based exporter of British bicycles. You have sold an order to an American firm for $1,000,000 worth of bicycles. Payment from the American firm (in U.S. dollars) is due in six months. Detail a strategy using futures contracts that will hedge your exchange rate risk.  
  
  
  
  
A. Go short 12 six-month forward contracts; pay £555,600.  
  
B. Go short 16 six-month forward contracts. Pay approximately £537,600.  
  
C. Go long 12 six-month forward contracts. Receive approximately £549,500.  
  
D. Go long 16 six-month forward contracts; raise approximately £537,600.

D. Go long 16 six-month forward contracts; raise approximately £537,600.

Your firm is a U.S.-based exporter of bicycles. You have sold an order to a French firm for €1,000,000 worth of bicycles. Payment from the French firm (in euro) is due in three months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and how much (in $) your firm will have.  
  
  
  
  
A. Go short 12 six-month forward contracts; pay $1,290,000.  
  
B. Go short 16 six-month forward contracts. Pay $1,230,000.  
  
C. Go long 16 six-month forward contracts; raise $1,230,000.  
  
D. Go long 12 six-month forward contracts. Receive $1,230,000.

B. Go short 16 six-month forward contracts. Pay $1,230,000.

Your firm is a U.K.-based exporter of bicycles. You have sold an order to a French firm for €1,000,000 worth of bicycles. Payment from the French firm (in euro) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go short 100 12-month euro futures contracts; and short 80 12-month pound futures contracts.  
  
B. Go long 100 12-month euro futures contracts; and long 80 12-month pound futures contracts.  
  
C. Go long 100 12-month euro futures contracts; and short 80 12-month pound futures contracts.  
  
D. Go short 100 12-month euro futures contracts; and long 80 12-month pound futures contracts.  
  
E. None of the above

D. Go short 100 12-month euro futures contracts; and long 80 12-month pound futures contracts.

Your firm is a U.K.-based importer of bicycles. You have placed an order with an Italian firm for €1,000,000 worth of bicycles. Payment (in euro) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go short 100 12-month euro futures contracts; and short 80 12-month pound futures contracts.  
  
B. Go long 100 12-month euro futures contracts; and long 80 12-month pound futures contracts.  
  
C. Go long 100 12-month euro futures contracts; and short 80 12-month pound futures contracts.  
  
D. Go short 100 12-month euro futures contracts; and long 80 12-month pound futures contracts.  
  
E. None of the above

C. Go long 100 12-month euro futures contracts; and short 80 12-month pound futures contracts.

Your firm is a Swiss exporter of bicycles. You have sold an order to a French firm for €1,000,000 worth of bicycles. Payment from the French firm (in euro) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go short 100 12-month euro futures contracts; and short 160 12-month SFr. futures contracts.  
  
B. Go long 100 12-month € futures contracts; and long 160 12-month SFr. futures contracts.  
  
C. Go long 100 12-month euro futures contracts; and short 160 12-month Swiss Franc futures contracts.  
  
D. Go short 100 12-month euro futures contracts; and long 160 12-month Swiss Franc futures contracts.  
  
E. None of the above

D. Go short 100 12-month euro futures contracts; and long 160 12-month Swiss Franc futures contracts.

Your firm is a Swiss importer of bicycles. You have placed an order with an Italian firm for €1,000,000 worth of bicycles. Payment (in euro) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go short 100 12-month euro futures contracts; and short 160 12-month SFr. futures contracts.  
  
B. Go long 100 12-month € futures contracts; and long 160 12-month SFr. futures contracts.  
  
C. Go long 100 12-month euro futures contracts; and short 160 12-month Swiss Franc futures contracts.  
  
D. Go short 100 12-month euro futures contracts; and long 160 12-month Swiss Franc futures contracts.  
  
E. None of the above

C. Go long 100 12-month euro futures contracts; and short 160 12-month Swiss Franc futures contracts.

Your firm is an Italian exporter of bicycles. You have sold an order to a British firm for £1,000,000 worth of bicycles. Payment from the customer (in pounds sterling) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go long 100 12-month pound futures contracts; and long 125 12-month euro futures contracts.  
  
B. Go short 100 12-month pound futures contracts; and short 125 12-month euro futures contracts.  
  
C. Go long 100 12-month pound futures contracts; and short 125 12-month euro futures contracts.  
  
D. Go short 100 12-month pound futures contracts; and long 125 12-month euro futures contracts.

D. Go short 100 12-month pound futures contracts; and long 125 12-month euro futures contracts.

29. Your firm is an Italian importer of bicycles. You have placed an order with a British firm for £1,000,000 worth of bicycles. Payment (in pounds sterling) is due in 12 months. Detail a strategy using futures contracts that will hedge your exchange rate risk. Have an estimate of how many contracts of what type and maturity.  
  
  
  
  
A. Go long 100 12-month pound futures contracts; and long 125 12-month euro futures contracts.  
  
B. Go short 100 12-month pound futures contracts; and short 125 12-month euro futures contracts.  
  
C. Go long 100 12-month pound futures contracts; and short 125 12-month euro futures contracts.  
  
D. Go short 100 12-month pound futures contracts; and long 125 12-month euro futures contracts.  
  
E. None of the above

C. Go long 100 12-month pound futures contracts; and short 125 12-month euro futures contracts.

From the perspective of a corporate CFO, when hedging a payable versus a receivable  
  
  
A. credit risk considerations are more germane for a payable.  
  
B. credit risk considerations are more germane for a receivable.  
  
C. none of the above

B. credit risk considerations are more germane for a receivable.

A U.S. firm has sold an Italian firm €1,000,000 worth of product. In one year the U.S. firm gets paid. To hedge, the U.S. firm bought put options on the euro with a strike price of $1.65. They paid an option premium $0.01 per euro. If at maturity, the exchange rate is $1.60,  
  
  
A. the firm will realize $1,145,000 on the sale net of the cost of hedging.  
  
B. the firm will realize $1,150,000 on the sale net of the cost of hedging.  
  
C. the firm will realize $1,140,000 on the sale net of the cost of hedging.  
  
D. none of the above

C. the firm will realize $1,140,000 on the sale net of the cost of hedging.

Buying a currency option provides  
  
  
A. a flexible hedge against exchange exposure.  
  
B. limits the downside risk while preserving the upside potential.  
  
C. a right, but not an obligation, to buy or sell a currency.  
  
D. all of the above

D. all of the above

Which of the following options strategies are internally consistent?  
  
  
A. Sell puts and buy calls  
  
B. Buy puts and sell calls  
  
C. Buy puts and buy calls  
  
D. Both a and b

D. Both a and b

XYZ Corporation, located in the United States, has an accounts payable obligation of ¥750 million payable in one year to a bank in Tokyo. Which of the following is NOT part of a money market hedge?  
  
  
A. Buy the ¥750 million at the forward exchange rate.  
  
B. Find the present value of ¥750 million at the Japanese interest rate.  
  
C. Buy that much yen at the spot exchange rate.  
  
D. Invest in risk-free Japanese securities with the same maturity as the accounts payable obligation.

A. Buy the ¥750 million at the forward exchange rate.

XYZ Corporation, located in the United States, has an accounts payable obligation of ¥750 million payable in one year to a bank in Tokyo. The current spot rate is ¥116/$1.00 and the one year forward rate is ¥109/$1.00. The annual interest rate is 3 percent in Japan and 6 percent in the United States. XYZ can also buy a one-year call option on yen at the strike price of $0.0086 per yen for a premium of 0.012 cent per yen. The future dollar cost of meeting this obligation **using the money market hedge** is  
  
  
A. $6,450,000.  
  
B. $6,545,400.  
  
C. $6,653,833.  
  
D. $6,880,734.

C. $6,653,833.

XYZ Corporation, located in the United States, has an accounts payable obligation of ¥750 million payable in one year to a bank in Tokyo. The current spot rate is ¥116/$1.00 and the one year forward rate is ¥109/$1.00. The annual interest rate is 3 percent in Japan and 6 percent in the United States. XYZ can also buy a one-year call option on yen at the strike price of $0.0086 per yen for a premium of 0.012 cent per yen. The future dollar cost of meeting this obligation **using the forward hedge** is  
  
  
A. $6,450,000.  
  
B. $6,545,400.  
  
C. $6,653,833.  
  
D. $6,880,734.

D. $6,880,734.

To hedge a foreign currency payable,  
  
  
A. buy call options on the foreign currency.  
  
B. buy put options on the foreign currency.  
  
C. sell call options on the foreign currency.  
  
D. sell put options on the foreign currency.

A. buy call options on the foreign currency.

To hedge a foreign currency receivable,  
  
  
A. buy call options on the foreign currency with a strike in the domestic currency.  
  
B. buy put options on the foreign currency with a strike in the domestic currency.  
  
C. sell call options on the foreign currency with a strike in the domestic currency.  
  
D. sell put options on the foreign currency with a strike in the domestic currency.

B. buy put options on the foreign currency with a strike in the domestic currency.

A call option on £1,000 with a strike price of €1,250 is equivalent to  
  
  
A. a put option on €1,250 with an exercise price of €1,000.  
  
B. a portfolio of options: a put on €1,250 with a strike price in dollars plus a call on £1,000 with a strike price in dollars.  
  
C. a put option on £1,000 with an exercise price of €1,250.  
  
D. both a and b

A. a put option on €1,250 with an exercise price of €1,000.

A call option to buy £10,000 at a strike price of $1.80 = £1.00 is equivalent to  
  
  
A. a put option to sell $18,000 at a strike price of $1.80 = £1.00.  
  
B. a call option on $18,000 at a strike price of $1.80 = £1.00.  
  
C. a put option on £10,000 at a strike price of $1.80 = £1.00.  
  
D. none of the above

A. a put option to sell $18,000 at a strike price of $1.80 = £1.00.

A put option to sell $18,000 at a strike price of $1.80 = £1.00 is equivalent to  
  
  
A. a call option to buy £10,000 at a strike price of $1.80 = £1.00.  
  
B. a call option on $18,000 at a strike price of $1.80 = £1.00.  
  
C. a put option on £10,000 at a strike price of $1.80 = £1.00.  
  
D. none of the above

A. a call option to buy £10,000 at a strike price of $1.80 = £1.00.

XYZ Corporation, located in the United States, has an accounts payable obligation of ¥750 million payable in one year to a bank in Tokyo. The current spot rate is ¥116/$1.00 and the one year forward rate is ¥109/$1.00. The annual interest rate is 3 percent in Japan and 6 percent in the United States. XYZ can also buy a one-year call option on yen at the strike price of $0.0086 per yen for a premium of 0.012 cent per yen. Assume that the forward rate is the best predictor of the future spot rate. The future dollar cost of meeting this obligation **using the option hedge** is  
  
  
A. $6,450,000.  
  
B. $6,545,400.  
  
C. $6,653,833.  
  
D. $6,880,734.

B. $6,545,400.

Your U.S. firm has a £100,000 payable with a 3-month maturity. Which of the following will hedge your liability?  
  
  
A. Buy the present value of £100,000 today at the spot exchange rate, invest in the U.K. at i£.  
  
B. Buy a call option on £100,000 with a strike price in dollars.  
  
C. Take a long position in a forward contract on £100,000 with a 3-month maturity.  
  
D. All of the above

D. All of the above

Your U.S. firm has a £100,000 payable with a 3-month maturity. Which of the following will hedge your liability?  
  
  
A. Buy a call option on £100,000 with a strike price in euro.  
  
B. Buy a put option on £100,000 with a strike price in dollars.  
  
C. Buy a call option on £100,000 with a strike price in dollars.  
  
D. None of the above

C. Buy a call option on £100,000 with a strike price in dollars.

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the London exchange in units of €10,000 with strike prices of £0.80 = €1.00.  
Options (calls and puts) are available on the Frankfurt exchange in units of £10,000 with strike prices of €1.25 = £1.00.  
For a U.K. firm to hedge a €100,000 payable,  
  
  
A. buy 10 call options on the euro with a strike in pounds sterling.  
  
B. buy 8 put options on the pound with a strike in euro.  
  
C. sell 10 call options on the euro with a strike in pounds sterling.  
  
D. sell 8 put options on the pound with a strike in euro.  
  
E. both a and b  
  
F. both c and d

E. both a and b

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the London exchange in units of €10,000 with strike prices of £0.80 = €1.00. Options (calls and puts) are available on the Frankfurt exchange in units of £10,000 with strike prices of €1.25 = £1.00. For a U.K. firm to hedge a €100,000 receivable,  
  
  
A. buy 10 call options on the euro with a strike in pounds sterling.  
  
B. buy 8 put options on the pound with a strike in euro.  
  
C. buy 10 put options on the euro with a strike in pounds sterling.  
  
D. buy 8 call options on the pound with a strike in euro.  
  
E. both a and b  
  
F. both c and d

F. both c and d

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the Philadelphia exchange in units of €10,000 with strike prices of $1.60/€1.00.  
Options (calls and puts) are available on the Philadelphia exchange in units of £10,000 with strike prices of $2.00/£1.00.  
For a U.S. firm to hedge a €100,000 payable,  
  
  
A. buy 10 call options on the euro with a strike in dollars.  
  
B. buy 8 put options on the pound with a strike in dollars.  
  
C. sell 10 call options on the euro with a strike in dollars.  
  
D. sell 8 put options on the pound with a strike in dollars.  
  
E. both a and b  
  
F. both c and d

A. buy 10 call options on the euro with a strike in dollars.

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the Philadelphia exchange in units of €10,000 with strike prices of $1.60/€1.00.  
Options (calls and puts) are available on the Philadelphia exchange in units of £10,000 with strike prices of $2.00/£1.00.  
For a U.S. firm to hedge a €100,000 receivable,  
  
  
A. buy 10 call options on the euro with a strike in dollars.  
  
B. buy 10 put options on the pound with a strike in dollars.  
  
C. sell 10 call options on the euro with a strike in dollars.  
  
D. sell 8 put options on the pound with a strike in dollars.  
  
E. both a and b  
  
F. both c and d

B. buy 10 put options on the pound with a strike in dollars.

Suppose that $2 = £1, $1.60 = €1, and the cross exchange rate is €1.25 = £1.00. If you own a call option on £10,000 with a strike price of $1.50, you would exercise this option at maturity if  
  
  
A. the $/£ exchange rate is at least $1.60/£.  
  
B. the $/€ exchange rate is at least $1.60/€.  
  
C. the €/£ exchange rate is at least €1.25/£.  
  
D. none of the above

D. none of the above

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the London exchange in units of €10,000 with strike prices of £0.80 = €1.00.  
Options (calls and puts) are available on the Frankfurt exchange in units of £10,000 with strike prices of €1.25 = £1.00.  
For an Italian firm to hedge a £100,000 payable,  
  
  
A. buy 10 call options on the pound with a strike in euro.  
  
B. buy 8 put options on the euro with a strike in pounds.  
  
C. both a and b will work.  
  
D. simultaneously use strategies a and b  
  
E. none of the above

C. both a and b will work.

Suppose that the exchange rate is €1.25 = £1.00.  
Options (calls and puts) are available on the London exchange in units of €10,000 with strike prices of £0.80 = €1.00. Options (calls and puts) are available on the Frankfurt exchange in units of £10,000 with strike prices of €1.25 = £1.00. For a French firm to hedge a £100,000 receivable,  
  
  
A. buy 10 call options on the pound with a strike in euro.  
  
B. buy 8 put options on the pound with a strike in euro.  
  
C. buy 10 put options on the pound with a strike in euro.  
  
D. buy 8 call options on the euro with a strike in pounds.  
  
E. both a and b  
  
F. both c and d

F. both c and d

A minor currency is  
  
  
A. anything other than the "big six": U.S. dollar, British pound, Japanese yen, euro, Canadian dollar, and Swiss franc.  
  
B. any currency that trades at less than one U.S. dollar.  
  
C. any currency that is less than a $20 denomination.  
  
D. none of the above

A. anything other than the "big six": U.S. dollar, British pound, Japanese yen, euro, Canadian dollar, and Swiss franc.

A U.S.-based MNC with exposure to the Swedish krona could best cross-hedge with  
  
  
A. forward contracts on the euro.  
  
B. forward contracts on the ruble.  
  
C. forward contracts on the pound.  
  
D. forward contracts on the yen.

A. forward contracts on the euro.

When cross-hedging,  
  
  
A. try to find one asset that has a positive correlation with another asset.  
  
B. the main thing is to find one asset that covaries with another asset in some predictable way.  
  
C. try to find one asset that has a negative correlation with another asset.  
  
D. none of the above

B. the main thing is to find one asset that covaries with another asset in some predictable way.

Your firm is bidding on a large construction contract in a foreign country. This contingent exposure could best be hedged  
  
  
A. with put options on the foreign currency.  
  
B. with call options on the foreign currency.  
  
C. both a and b, depending upon the specifics ("the rest of the story").  
  
D. with futures contracts.

C. both a and b, depending upon the specifics ("the rest of the story").

On a recent sale, Boeing allowed British Airways to pay either $18 million or £10 million.  
  
  
A. At the due date, British airways will be indifferent between paying dollars or pounds since they would of course have hedged their exposure either way.  
  
B. Boeing has provided British Airways with a free option to buy $18 million with an exercise price of £10 million.  
  
C. Boeing has provided British Airways with a free option to sell up to £10 million with an exercise price of $18 million.  
  
D. All of the above

D. All of the above

Contingent exposure can best be hedged with  
  
  
A. options.  
  
B. money market hedging.  
  
C. futures.  
  
D. all of the above

A. options.

A 5-year swap contract can be viewed as a portfolio of 5 forward contracts with maturities of 1, 2, 3, 4 and 5 years. One important exception is that  
  
  
A. the forward price is the same for the swap contract but not for the forward contracts.  
  
B. the swap contract will have daily resettlement.  
  
C. the forward contracts will have resettlement risk.  
  
D. none of the above.

A. the forward price is the same for the swap contract but not for the forward contracts.

To find the swap rate for a 3-year swap, you would  
  
  
A. take the arithmetic average of the 1-, 2-, and 3-year forward rates.  
  
B. take the geometric average of the 1-, 2-, and 3-year forward rates.  
  
C. bootstrap the LIBOR yield curve.  
  
D. none of the above

B. take the geometric average of the 1-, 2-, and 3-year forward rates.

Generally speaking, a firm with recurrent exposure can best hedge using which product?  
  
  
A. Options  
  
B. Swaps  
  
C. Futures  
  
D. All of the above

B. Swaps

The current exchange rate is €1.25 = £1.00 and a British firm offers a French customer the choice of paying a £10,000 bill due in 90 days with either £10,000 or €12,500.  
  
  
A. The seller has given the buyer an at-the-money put option.  
  
B. The seller has given the buyer an at-the-money call option.  
  
C. Both a and b are correct  
  
D. None of the above

C. Both a and b are correct

The current exchange rate is €1.25 = £1.00 and a British firm offers a French customer the choice of paying a £10,000 bill due in 90 days with either £10,000 or €12,500.  
  
  
A. The seller has given the buyer an at-the-money put option on euro with a strike in pounds.  
  
B. The seller has given the buyer an at-the-money put option on pounds with a strike in euro.  
  
C. The seller has given the buyer an at-the-money call option on euro with a strike in pounds.  
  
D. None of the above

A. The seller has given the buyer an at-the-money put option on euro with a strike in pounds.

An exporter can shift exchange rate risk to their customers by  
  
  
A. invoicing in their home currency.  
  
B. invoicing in their customer's local currency.  
  
C. splitting the difference, and invoicing half of sales in local currency and half of sales in home currency.  
  
D. invoicing sales in a currency basket such as the SDR as the invoice currency.

A. invoicing in their home currency.

An exporter can share exchange rate risk with their customers by  
  
  
A. invoicing in their customer's local currency.  
  
B. splitting the difference, and invoicing half of sales in local currency and half of sales in home currency.  
  
C. invoicing sales in a currency basket such as the SDR as the invoice currency.  
  
D. both b and c

D. both b and c

An exporter faced with exposure to a depreciating currency can reduce transaction exposure with a strategy of  
  
  
A. paying or collecting early.  
  
B. paying or collecting late.  
  
C. paying late, collecting early.  
  
D. paying early, collecting late.

C. paying late, collecting early.

An exporter faced with exposure to an appreciating currency can reduce transaction exposure with a strategy of  
  
  
A. paying or collecting early.  
  
B. paying or collecting late.  
  
C. paying late, collecting early.  
  
D. paying early, collecting late.

D. paying early, collecting late.

A MNC seeking to reduce transaction exposure with a strategy of leading and lagging  
  
  
A. can probably employ the strategy more effectively with intra firm payables and receivables than with customers or outside suppliers.  
  
B. can employ the strategy most easily with customers, regardless of market structure.  
  
C. can employ the strategy most easily with suppliers, regardless of market structure.  
  
D. none of the above

A. can probably employ the strategy more effectively with intra firm payables and receivables than with customers or outside suppliers.

92. Find the net exposure of the MNC with the following intra affiliate transactions shown.  
  
  
  
  
A. $55  
  
B. $65  
  
C. $800  
  
D. none of the above  
PowerPoint slides 39-41  
  
  
  
See PowerPoint

B. $65

In evaluating the pros and cons of corporate risk management, one argument against hedging is  
  
  
A. if the corporate guys were good at forecasting exchange rates, they would make more money on Wall Street, so only incompetent managers are left at corporations to hedge.  
  
B. shareholders who are diversified have already managed their exchange rate risk.  
  
C. the hedging costs go into someone else's pocket.  
  
D. none of the above

B. shareholders who are diversified have already managed their exchange rate risk.

If a firm faces progressive tax rates,  
  
  
A. they should spread income out across time and subsidiaries.  
  
B. they should focus on maximizing income in one division or subsidiary.  
  
C. they should manage their income recognition without regard to their taxes.  
  
D. none of the above

A. they should spread income out across time and subsidiaries.

In evaluating the pros and cons of corporate risk management, "market imperfections" refer to  
  
  
A. information asymmetry, differential transaction costs, default costs, and progressive corporate taxes.  
  
B. leading and lagging, receivables and payables, and diversification costs.  
  
C. economic costs, noneconomic costs, arbitrage costs, and hedging costs.  
  
D. management costs, corporate costs, liquidity costs, and trading costs.

A. information asymmetry, differential transaction costs, default costs, and progressive corporate taxes.

ABC Inc., an exporting firm, expects to earn $20 million if the dollar depreciates, but only $10 million if the dollar appreciates. Assume that the dollar has an equal chance of appreciating or depreciating. Calculate the expected tax of ABC if it is operating in a foreign country that has progressive corporate taxes as shown below:  
Corporate income tax rate = 15% for the first $7,500,000.  
Corporate income tax rate = 30% for earnings exceeding $7,500,000.  
  
  
A. $3,375,000  
  
B. $6,000,000  
  
C. $1,500,000  
  
D. $4,500,000

A. $3,375,000

ABC Inc., an exporting firm, expects to earn $20 million if the dollar depreciates, but only $10 million if the dollar appreciates. Assume that the dollar has an equal chance of appreciating or depreciating. Step one: calculate the expected tax of ABC if it is operating in a foreign country that has progressive corporate taxes as shown below:  
Corporate income tax rate = 15% for the first $7,500,000.  
Corporate income tax rate = 30% for earnings exceeding $7,500,000.  
Step two: ABC is considering implementing a hedging program that will eliminate their exchange rate risk: they will make a certain $15 million whether or not the dollar appreciates or depreciates. How much will they save in taxes if they implement the program?  
  
  
A. $0  
  
B. $3,375,000  
  
C. $1,500,000  
  
D. $4,500,000

A. $0

A study of Fortune 500 firms hedging practices shows that  
  
  
A. over 90 percent of Fortune 500 firms use forward contracts.  
  
B. over 90 percent of Fortune 500 firms use options contracts.  
  
C. both a and b  
  
D. none of the above

A. over 90 percent of Fortune 500 firms use forward contracts.

**CHAP 9**

Suppose the U.S. dollar substantially depreciates against the Japanese yen. The change in exchange rate  
  
A. can have significant economic consequences for U.S. firms.  
  
B. can have significant economic consequences for Japanese firms.  
  
C. can have significant economic consequences for both U.S. and Japanese firms.  
  
D. none of the above

C. can have significant economic consequences for both U.S. and Japanese firms.

Suppose the U.S. dollar substantially depreciates against the Japanese yen. The change in exchange rate  
  
A. will tend to weaken the competitive position of import-competing U.S. car makers.  
  
B. will tend to strengthen the competitive position of import-competing U.S. car makers.  
  
C. will tend to strengthen the competitive position of Japanese car makers at the expense of U.S. makers.  
  
D. none of the above

B. will tend to strengthen the competitive position of import-competing U.S. car makers.

The link between a firm's future operating cash flows and exchange rate fluctuations is  
  
A. asset exposure.  
  
B. operating exposure.  
  
C. both a and b  
  
D. none of the above

B. operating exposure.

When the Mexican peso collapsed in 1994, declining by 37 percent,  
  
A. U.S. firms that exported to Mexico and priced in peso were adversely affected.  
  
B. U.S. firms that exported to Mexico and priced in dollars were adversely affected.  
  
C. U.S. firms were unaffected by the peso collapse, since Mexico is such a small market.  
  
D. both a and b

D. both a and b

When exchange rates change,  
  
A. U.S. firms that produce domestically and sell only to domestic customers will be unaffected.  
  
B. U.S. firms that produce domestically and sell only to domestic customers can be affected if they compete against imports.  
  
C. U.S. firms that produce domestically and sell only to domestic customers will be affected, but only if they borrow in foreign currency to finance their domestic operations.  
  
D. both a and b

B. U.S. firms that produce domestically and sell only to domestic customers can be affected if they compete against imports.

When exchange rates change,  
  
A. this can alter the operating cash flow of a domestic firm.  
  
B. this can alter the competitive position of a domestic firm.  
  
C. this can alter the home currency values of a multinational firm's assets and liabilities.  
  
D. all of the above

D. all of the above

Two studies found a link between exchange rates and the stock prices of U.S. firms,  
  
A. this suggests that exchange rate changes can systematically affect the value of the firm by influencing its operating cash flows.  
  
B. this suggests that exchange rate changes can systematically affect the value of the firm by influencing the domestic currency values of its assets and liabilities.  
  
C. both a and b  
  
D. none of the above

C. both a and b

It is conventional to classify foreign currency exposures into the following types:  
  
A. economic exposure, transaction exposure, and translation exposure.  
  
B. economic exposure, noneconomic exposure, and political exposure.  
  
C. national exposure, international exposure, and trade exposure.  
  
D. conversion exposure, and exchange exposure.

A. economic exposure, transaction exposure, and translation exposure.

Exposure to currency risk can be measured by the sensitivities of  
  
A. the future home currency values of the firm's assets and liabilities.  
  
B. the firm's operating cash flows to random changes in exchange rates.  
  
C. both a and b  
  
D. none of the above

C. both a and b

Operating exposure measures  
  
  
A. the extent to which the foreign currency value of the firm's assets is affected by unanticipated changes in exchange rates.  
  
B. the extent to which the firm's operating cash flows will be affected by unexpected changes in exchange rates.  
  
C. the affect of changes in exchange rates will have on the consolidated financial reports of a MNC.  
  
D. the affect of unanticipated changes in exchange rates on the dollar value of contractual obligations denominated in a foreign currency.

B. the extent to which the firm's operating cash flows will be affected by unexpected changes in exchange rates.

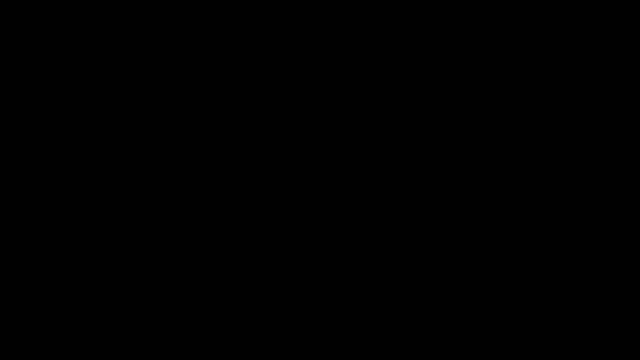
Economic exposure refers to  
  
A. the sensitivity of realized domestic currency values of the firm's contractual cash flows denominated in foreign currencies to unexpected exchange rate changes.  
  
B. the extent to which the value of the firm would be affected by unanticipated changes in exchange rate.  
  
C. the potential that the firm's consolidated financial statement can be affected by changes in exchange rates.  
  
D. ex post and ex ante currency exposures.

B. the extent to which the value of the firm would be affected by unanticipated changes in exchange rate.

Currency risk  
  
A. is the same as currency exposure.  
  
B. represents random changes in exchange rates.  
  
C. measure "what the firm has at risk."  
  
D. both a and b

B. represents random changes in exchange rates.

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Nâng cấp để gỡ bỏ quảng cáo

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Suppose a U.S.-based MNC maintains a vacation home for employees in the British countryside and the local price of this property is always moving together with the pound price of the U.S. dollar. As a result,  
  
A. whenever the pound depreciates against the dollar, the local currency price of this property goes up by the same proportion.  
  
B. the firm is not exposed to currency risk even if the pound-dollar exchange rate fluctuates randomly.  
  
C. both a and b  
  
D. none of the above

C. both a and b

The link between the home currency value of a firm's assets and liabilities and exchange rate fluctuations is  
  
A. asset exposure.  
  
B. operating exposure.  
  
C. both a and b  
  
D. none of the above

A. asset exposure.

A purely domestic firm that sources and sells only domestically,  
  
A. faces exchange rate risk to the extent that it has international competitors in the domestic market.  
  
B. faces no exchange rate risk.  
  
C. should never hedge since this could actually increase its currency exposure.  
  
D. both b and c

A. faces exchange rate risk to the extent that it has international competitors in the domestic market.

In recent years, the U.S. dollar has depreciated substantially against most major currencies of the world, especially against the euro.  
  
A. The stronger euro has made many European products more expensive in dollar terms, hurting sales of these products in the United States.  
  
B. The stronger euro has made many American products less expensive in euro terms, boosting sales of U.S. products in Europe.  
  
C. Both a and b  
  
D. None of the above

C. Both a and b

In recent years,  
  
A. the U.S. dollar has appreciated substantially against most major currencies of the world, especially against the euro.  
  
B. the U.S. dollar has depreciated substantially against most major currencies of the world, especially against the euro.  
  
C. the U.S. dollar has maintained its value against most major currencies of the world, especially against the euro.

B. the U.S. dollar has depreciated substantially against most major currencies of the world, especially against the euro.

From the perspective of the U.S. firm that owns an asset in Britain, the exposure that can be measured by the coefficient b in regressing the dollar value P of the British asset on the dollar/pound exchange rate S using the regression equation is  
  
  
A. asset exposure.  
  
B. operating exposure.  
  
C. accounting exposure.  
  
D. none of the above

A. asset exposure.

What does it mean to have redenominated an asset in terms of the dollar?  
  
A. You have undertaken a hedging strategy that gives the asset a constant dollar value.  
  
B. Multiply the foreign currency value of the asset by the spot exchange rate.  
  
C. Undertaken accounting changes to eliminate translation exposure.  
  
D. None of the above

A. You have undertaken a hedging strategy that gives the asset a constant dollar value.

A firm with a highly elastic demand for its products  
  
  
A. will be unable to pass increased costs following unfavorable changes in the exchange rate without significantly lowering the quantity sold.  
  
B. will be able to raise prices following unfavorable changes in the exchange rate without significantly lowering the quantity sold.  
  
C. can easily pass increased costs on to consumers.  
  
D. will sell about the same amount of product regardless of price.

A. will be unable to pass increased costs following unfavorable changes in the exchange rate without significantly lowering the quantity sold.

Operating exposure can be defined as  
  
  
A.  
the link between the future home currency values of the firm's assets and liabilities and exchange rate fluctuations.  
  
B.  
the extent to which the firm's operating cash flows would be affected by random changes in exchange rates.  
  
C.  
the sensitivity of realized domestic currency values of the firm's contractual cash flows denominated in foreign currencies to unexpected exchange rate changes.  
  
D.  
the potential that the firm's consolidated financial statement can be affected by changes in exchange rates.

B.  
the extent to which the firm's operating cash flows would be affected by random changes in exchange rates.

The extent to which the firm's operating cash flows would be affected by random changes in exchange rates is called  
  
A. asset exposure.  
  
B. operating exposure.  
  
C. both a and b  
  
D. none of the above

B. operating exposure.

The variability of the dollar value of an asset (invested overseas) depends on  
  
A. the variability of the dollar value of the asset that is related to random changes in the exchange rate.  
  
B. the dollar value variability that is independent of exchange rate movements.  
  
C. both a and b  
  
D. none of the above

C. both a and b

Consider a U.S. MNC who owns a foreign asset. If the foreign currency value of the asset is inversely related to changes in the dollar-foreign currency exchange rate,  
  
  
A.  
The company has a built-in hedge.  
  
B.  
the dollar value variability that is independent of exchange rate movements.  
  
C.  
both a and b  
  
D.  
none of the above

C.  
both a and b

With regard to operational hedging versus financial hedging,  
  
  
A.  
operational hedging provides a more stable long-term approach than does financial hedging.  
  
B.  
financial hedging, when instituted on a rollover basis, is a superior long-term approach to operational hedging.  
  
C.  
since they both have the same goal, stabilizing the firm's cash flows in domestic currency, they are fungible in use.  
  
D.  
none of the above

A.  
operational hedging provides a more stable long-term approach than does financial hedging.

Which of the following are identified by your text as a strategy for managing operating exposure:  
  
1) Selecting low-cost production sites  
2) Flexible sourcing policy  
3) Diversification of the market  
4) Product differentiation and R&D efforts  
5) Financial Hedging  
  
A. 1), 3), and 5) only  
  
B. 2) and 4) only  
  
C. 1), 4), and 5) only  
  
D. 1), 2), 3), 4), and 5)

D. 1), 2), 3), 4), and 5)

Which of the following would be an effective hedge?  
  
  
A.  
Sell 53 Israeli shekels forward at the 1-year forward rate, F1($/IS), that prevails at time zero.  
  
B.  
Buy 53 Israeli shekels forward at the 1-year forward rate, F1($/IS), that prevails at time zero.  
  
C.  
Sell 12,898 Israeli shekels forward at the 1-year forward rate, F1($/IS), that prevails at time zero.  
  
D.  
None of the above

B.  
Buy 53 Israeli shekels forward at the 1-year forward rate, F1($/IS), that prevails at time zero.

Consider a U.S.-based MNC with a wholly-owned Italian subsidiary. Following a depreciation of the dollar against the euro, which of the following conclusions are correct?  
  
A. The cash flow in euro could be altered due an alteration in the firm's competitive position in the marketplace.  
  
B. A given operating cash flow in euro will be converted to a higher U.S. dollar cash flow.  
  
C. Both a and b  
  
D. None of the above

C. Both a and b

Consider a U.S.-based MNC with a wholly-owned Italian subsidiary. Following a depreciation of the dollar against the euro, which of the following describes the competitive effect of the depreciation?  
  
  
A.  
The cash flow in euro could be altered due an alteration in the firm's competitive position in the marketplace.  
  
B.  
A given operating cash flow in euro will be translated to a higher U.S. dollar cash flow.  
  
C.  
Both a and b  
  
D.  
None of the above

A.  
The cash flow in euro could be altered due an alteration in the firm's competitive position in the marketplace.

Consider a U.S. MNC with operations in Great Britain. Which of the following are potential risks following a strengthening of the dollar?  
  
A. A pound sterling depreciation may affect operating cash flow in pounds by altering the firm's competitive position in the marketplace.  
  
B. A given operating cash flow in pounds will be converted into a lower dollar amount after the pound depreciation.  
  
C. Both a and b  
  
D. None of the above

C. Both a and b

Which of the following is false?  
  
  
A. The competitive effect is that a depreciation may affect operating cash flow in the foreign currency by altering the firm's competitive position in the marketplace.  
  
B. The conversion effect is defined as a given operating cash flow in a foreign currency will be converted into a lower dollar amount after a currency depreciation.  
  
C. The competitive effect is defined as a given operating cash flow in a foreign currency will be converted into a lower dollar amount after a currency depreciation.  
  
D. None of the above

C. The competitive effect is defined as a given operating cash flow in a foreign currency will be converted into a lower dollar amount after a currency depreciation.

Consider a U.S.-based MNC with a wholly-owned German subsidiary. Following a depreciation of the dollar against the euro, which of the following describes the conversion effect of the depreciation?  
  
A. The cash flow in euro could be altered due a change in the firm's competitive position in the marketplace.  
  
B. A given operating cash flow in euro will be translated to a higher U.S. dollar cash flow.  
  
C.  
Both a and b  
  
D.  
None of the above

B. A given operating cash flow in euro will be translated to a higher U.S. dollar cash flow.

Consider a U.S.-based MNC with a wholly-owned French subsidiary. Following a depreciation of the dollar against the euro, which of the following best describes the mechanism of any effect of the depreciation?  
  
A. The change in the cash flow in euro due an alteration in the firm's competitive position in the marketplace is in part a function of the elasticity of demand for the firm's product.  
  
B. A given operating cash flow in euro will be translated to a higher U.S. dollar cash flow regardless of the firm's hedging program.  
  
C.  
Both a and b  
  
D.  
None of the above

A. The change in the cash flow in euro due an alteration in the firm's competitive position in the marketplace is in part a function of the elasticity of demand for the firm's product.

Which of the following is true?  
  
A.  
The competitive effect is that a currency depreciation may affect operating cash flow in the foreign currency by altering the firm's competitive position in the marketplace.  
  
B.  
The conversion effect is defined as a given accounting cash value in a foreign currency will be converted into a lower dollar amount after currency depreciation.  
  
C.  
The competitive effect is defined as a given operating cash flow in a foreign currency will be converted into a lower dollar amount after a currency depreciation.  
  
D.  
None of the above

A. The competitive effect is that a currency depreciation may affect operating cash flow in the foreign currency by altering the firm's competitive position in the marketplace.

Consider a U.S.-based MNC with a wholly-owned European subsidiary selling a product sourced in euro and priced in euro with inelastic demand. Following a depreciation of the dollar against the euro, which of the following is the most true?  
  
A. Since they have inelastic demand, the U.S. firm can just pass through the impact of the exchange rate change.  
  
B. Since they have elastic demand, the U.S. firm cannot just pass through the impact of the exchange rate change.  
  
C. Since the exchange rate movement was favorable to the U.S. firm, there is no impact on the firm's position.  
  
D. None of the above.

D. None of the above.

A firm's operating exposure is  
  
A. defined as the extent to which the firm's operating cash flows would be affected by the random changes in exchange rates.  
  
B. determined by the structure of the markets in which the firm sources its inputs, such as labor and materials, and sells its products.  
  
C. determined by the firm's ability to mitigate the effect of exchange rate changes by adjusting its markets, product mix, and sourcing.  
  
D. all of the above

D. all of the above

Generally speaking, a firm is subject to high degrees of operating exposure  
  
A.  
when its costs are sensitive to exchange rate changes.  
  
B.  
when its prices are sensitive to exchange rate changes.  
  
C.  
when either its cost or its price is sensitive to exchange rate changes.  
  
D.  
none of the above

C.  
when either its cost or its price is sensitive to exchange rate changes.

Generally speaking, when both a firm's costs and its price is sensitive to exchange rate changes  
  
  
A.  
the firm is not subject to high degrees of operating exposure.  
  
B.  
the firm is subject to high degrees of operating exposure.  
  
C.  
the firm should hedge.  
  
D.  
none of the above

A.  
the firm is not subject to high degrees of operating exposure.

The firm may not be subject to high degrees of operating exposure  
  
A. when changes in real exchange rates are exactly offset by the inflation differential.  
  
B. when changes in nominal exchange rates are exactly matched by the inflation differential.  
  
C. when changes in nominal exchange rates are exactly offset by the inflation differential.  
  
D. none of the above

C. when changes in nominal exchange rates are exactly offset by the inflation differential.

The firm may not be able to pass through changes in the exchange rate  
  
A. in markets with low product differentiation.  
  
B. in markets with high price elasticities.  
  
C. both a and b  
  
D. none of the above

C. both a and b

The firm may not be able to pass through changes in the exchange rate  
  
  
A.  
in markets with mainly domestics (foreign to the firm) competitors.  
  
B.  
in markets with low price elasticities.  
  
C.  
both a and b  
  
D.  
none of the above

A.  
in markets with mainly domestics (foreign to the firm) competitors.

Generally speaking, a firm is subject to high degrees of operating exposure when  
  
  
A.  
either its cost or its price is sensitive to exchange rate changes.  
  
B.  
both the cost and the price are sensitive to exchange rate changes.  
  
C.  
both the cost and the price are insensitive to exchange rate changes.  
  
D.  
none of the above

A.  
either its cost or its price is sensitive to exchange rate changes.

What is the objective of managing operating exposure?  
  
A. Stabilize cash flows in the face of fluctuating exchange rates.  
  
B. Selecting low cost production sites.  
  
C. Increase the variability of cash flows in the face of fluctuating exchange rates.  
  
D. Both a and c

A. Stabilize cash flows in the face of fluctuating exchange rates.

What is the objective of managing operating exposure?  
  
  
A.  
Stabilize accounting results in the face of fluctuating exchange rates.  
  
B.  
Selecting low cost production sites.  
  
C.  
Increase the variability of cash flows in the face of fluctuating exchange rates.  
  
D.  
None of the above

D.  
None of the above

Managing operating exposure  
  
  
A.  
is a short-term tactical issue.  
  
B.  
is a long-term issue, like selecting a site for a factory.  
  
C.  
is relatively unimportant, since most MNCs have a built-in hedge.  
  
D.  
none of the above

B. is a long-term issue, like selecting a site for a factory.

Which of the following can a company use to manage operating exposure?  
  
A. Selecting low-cost production sites, diversifying the market.  
  
B. Low cost production sites, but not financial hedging.  
  
C. Pursuing a flexible sourcing policy, product differentiation, R&D efforts.  
  
D. Both a and c.

D. Both a and c.

When the domestic currency is strong or expected to become strong,  
  
  
A.  
this could erode the competitive position of the firm's exports.  
  
B.  
this could erode the competitive position of the firm's import competition.  
  
C.  
the firm should consider locating production facilities in a foreign country where costs are low.  
  
D.  
both a and c

D.  
both a and c

A foreign country could provide low cost production sites  
  
  
A.  
because the factors of production are underpriced.  
  
B.  
because the currency is undervalued.  
  
C.  
because the locals like to give away their land labor and capital to foreigners.  
  
D.  
both a and b

D.  
both a and b

While maintaining multiple production sites does provide a firm valuable options,  
  
  
A.  
a firm may miss out on economies of scope.  
  
B.  
a firm may miss out on economies of scale.  
  
C.  
a firm may find that exchange rate changes can fully offset the advantage of multiple manufacturing sites.  
  
D.  
both a and b

B.  
a firm may miss out on economies of scale.

Goldman Sachs estimates that as much as \_\_% of the pretax profits that Porsche reported for a recent fiscal year came from skillfully executing currency options.  
  
  
A. 5  
  
B. 10  
  
C. 15  
  
D. 75

D. 75

Developing multiple production sites in a variety of countries,  
  
A. can create an excess capacity problem.  
  
B. can lead to underutilization of domestic plants.  
  
C. can lead to domestic job losses.  
  
D. all of the above

D. all of the above

A flexible sourcing policy  
  
  
A.  
is primarily concerned with low-cost (and often low-quality) vendors.  
  
B.  
need not be confined just to materials and parts.  
  
C.  
only works for manufacturing firms, not service firms.  
  
D.  
puts the focus on the exchange rate at the expense of shipping rates.

B.  
need not be confined just to materials and parts.

A firm that is committed to keeping manufacturing facilities in only the home country (and not developing multiple production sites in a variety of countries) can  
  
A. not mitigate the effects of exchange rate changes.  
  
B. lessen the effect of exchange rate changes by sourcing from where input costs are low.  
  
C. focus on selling commodity products with product differentiation.  
  
D. pursue a strategy of increasing its products price elasticity of demand.

B. lessen the effect of exchange rate changes by sourcing from where input costs are low.

If the domestic currency is strong or expected to become strong,  
  
A. a firm can choose to locate production facilities in a foreign country where costs are low due to either the undervalued currency or underpriced factors of production.  
  
B. a firm should curtail R&D efforts until the exchange rate situation improves.  
  
C. a firm should abandon international sales and focus on domestic market share.  
  
D. the firm should focus on profiting in the currency futures market based on its forecasts.

A. a firm can choose to locate production facilities in a foreign country where costs are low due to either the undervalued currency or underpriced factors of production.

Which of the following is a true statement?  
  
  
A.  
As long as exchange rates do not always move in the same direction, the firm can stabilize its operating cash flows by diversifying its export market.  
  
B.  
The firm should not get into new lines of business solely to diversify exchange risk because conglomerate expansion can bring about inefficiency and losses.  
  
C.  
All of the above are true  
  
D.  
None of the above is true

C.  
All of the above are true

A firm that is committed to keeping manufacturing facilities in only the home country (and not developing multiple production sites in a variety of countries) can  
  
A. lessen the effect of exchange rate changes by pursuing a strategy of diversifying the markets in which the firm's products are sold.  
  
B.  
not mitigate the effects of exchange rate changes.  
  
C.  
lessen the effect of exchange rate changes by pursuing a strategy of selling commodity products without product differentiation.  
  
D.  
pursue a strategy of increasing its products price elasticity of demand.

A. lessen the effect of exchange rate changes by pursuing a strategy of diversifying the markets in which the firm's products are sold.

It can be argued that, while financial hedging can be used to stabilize a firm's cash flows,  
  
A.  
it is not a substitute for long-term operational hedging.  
  
B.  
it is therefore a substitute for long-term operational hedging.  
  
C.  
it is inferior to money market hedging.  
  
D.  
none of the above.

A.  
it is not a substitute for long-term operational hedging.

Investments in R&D  
  
A. are usually a waste of time and money.  
  
B. can allow the firm to maintain and strengthen its competitive position.  
  
C. can allow the firm to cut costs and enhance productivity.  
  
D. both b and c

D. both b and c

The price elasticity of demand for unique products tends to be  
  
A.  
highly elastic.  
  
B.  
highly inelastic.  
  
C.  
both a and b  
  
D.  
none of the above

B.  
highly inelastic.

The price elasticity of demand for commodity products tends to be  
  
  
A.  
highly elastic.  
  
B.  
highly inelastic.  
  
C.  
both a and b  
  
D.  
none of the above

A.  
highly elastic.

96.  
Investment in R&D activities can allow the firm to maintain and strengthen its competitive position in the face of adverse exchange rate movements. The mechanism for this includes  
  
  
A.  
  
successful R&D efforts allow the firm to cut costs and enhance productivity.  
  
  
  
B.  
  
R&D efforts can lead to the introduction of new and unique products for which competitors offer no close substitutes—since the demand for unique products tends to be highly inelastic the firm would be less exposed to exchange risk.  
  
  
  
C.  
  
successful R&D efforts can create a perception among consumers that its product is indeed different from those offered by competitors. Once the firm's product acquires a unique identity, its demand is less likely to be price-sensitive.  
  
  
  
D.  
  
all of the above

D.  
  
all of the above

If the stock market of a foreign country is consistently up when the dollar value of the currency is down,  
  
A. there may not be a great deal of exchange rate risk for a U.S.-based investor.  
  
B. there will be a great deal of exchange rate risk for a U.S.-based investor.  
  
C. then investors can ignore diversification.  
  
D.  
none of the above

A. there may not be a great deal of exchange rate risk for a U.S.-based investor.

**CHAP 10**

Under the monetary/nonmonetary method, revenue and expense items associated with nonmonetary accounts, such as cost of goods sold and depreciation, are translated at the historical rate associated with the balance sheet account.  
  
TRUE/FALSE

TRUE

Translation exposure refers to  
  
A. accounting exposure.  
  
B. the effect that an unanticipated change in exchange rates will have on the consolidated financial reports of an MNC.  
  
C. the change in the value of a foreign subsidiaries assets and liabilities denominated in a foreign currency, as a result of exchange rate change fluctuations, when viewed from the perspective of the parent firm.  
  
D. all of the above

D. all of the above

The recognized methods for consolidating the financial reports of an MNC are  
  
  
A.  
short/long term method, current/future method, flexible/inflexible method, and economic/noneconomic method.  
  
B.  
current/noncurrent method, monetary/nonmonetary method, short/long term method, and current/future method.  
  
C.  
current/noncurrent method, monetary/nonmonetary method, temporal method, and current rate method.  
  
D.  
temporal method, current rate method, flexible/inflexible method, and economic/noneconomic method.

C.  
current/noncurrent method, monetary/nonmonetary method, temporal method, and current rate method.

How many methods of foreign currency translation have been used in recent years? (U.S. GAAP.)  
  
A. One  
  
B. Two  
  
C. Three  
  
D. Four

D. Four

Translation exposure, also frequently called accounting exposure, refers to the effect that an unanticipated change in exchange rates will have on the  
  
A. choice of accounting methodology.  
  
B. consolidated financial reports of a MNC.  
  
C. firms competitive position.  
  
D. cash flows realized from foreign operations.

B. consolidated financial reports of a MNC.

When exchange rates change, the value of a foreign subsidiary's assets and liabilities denominated in a foreign currency change  
  
  
A. when they are viewed from the perspective of the subsidiary firm.  
  
B. when they are viewed from the perspective of the parent firm.  
  
C. but this is only of material concern if the parent firm is liquidating the subsidiary in a bankruptcy and is forced to realize the value of the assets and liabilities at the current exchange rate.  
  
D. none of the above

B. when they are viewed from the perspective of the parent firm.

The sensitivity of "realized" domestic currency values of the firm's contractual cash flows denominated in foreign currency to unexpected changes in the exchange rate is  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

A. transaction exposure.

The management of translation exposure is best described as  
  
A. selecting a mechanical means for handling the consolidation process for MNCs that logically deals with exchange rate changes.  
  
B. selecting a mechanical means for handling the consolidation process for MNCs that makes this quarter's accounting numbers as attractive as possible.  
  
C. selecting a mechanical means for handling the consolidation process for MNCs that treats inventory valuation as LIFO on the income statement and FIFO on the balance sheet.  
  
D. selecting a mechanical means for handling the consolidation process for MNCs that treats inventory valuation as FIFO on the income statement and LIFO on the balance sheet.

A. selecting a mechanical means for handling the consolidation process for MNCs that logically deals with exchange rate changes.

The sensitivity of the firm's consolidated financial statements to unexpected changes in the exchange rate is  
  
  
A.  
transaction exposure.  
  
B.  
translation exposure.  
  
C.  
economic exposure.  
  
D.  
none of the above

B.  
translation exposure.

The extent to which the value of the firm would be affected by unexpected changes in the exchange rate is  
  
  
A. transaction exposure.  
  
B. translation exposure.  
  
C. economic exposure.  
  
D. none of the above

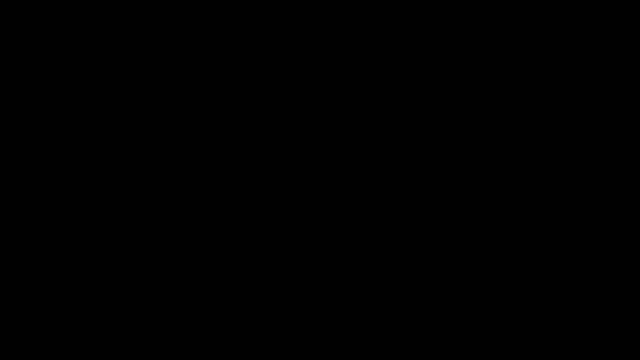
C. economic exposure.

Which of the following is true?  
  
  
A.  
The competitive effect is defined as the impact that a currency depreciation may have on the operating cash flow in the foreign currency by altering the firm's competitive position in the marketplace.  
  
B.  
The conversion effect is defined as a given accounting cash value in a foreign currency will be converted into a lower dollar amount after currency depreciation.  
  
C.  
The competitive effect is defined as a given operating cash flow in a foreign currency will be converted into a lower dollar amount after a currency depreciation.  
  
D.  
None of the above

A.  
The competitive effect is defined as the impact that a currency depreciation may have on the operating cash flow in the foreign currency by altering the firm's competitive position in the marketplace.

What does it mean to have redenominated an asset in terms of the dollar?  
  
A. You have undertaken a hedging strategy that gives the asset a constant dollar value.  
  
B. Multiply the foreign currency value of the asset by the spot exchange rate.  
  
C. Undertaken accounting changes to eliminate translation exposure.  
  
D. None of the above

A. You have undertaken a hedging strategy that gives the asset a constant dollar value.



Nâng cấp để gỡ bỏ quảng cáo

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The authoritative body in the United States that specifies accounting policy for U.S. business firms and certified public accounting firms.  
  
  
A.  
The Federal Accounting Standards Board (FASB).  
  
B.  
The International Accounting Standards Board (IASB).  
  
C.  
The Financial Accounting Standards Board (FASB).  
  
D.  
The Securities and Exchange Commission (SEC).

C.  
The Financial Accounting Standards Board (FASB).

The difference between accounting exposure and translation exposure  
  
  
A.  
translation is about going from one language to another, accounting is just about the numbers.  
  
B.  
accounting exposure and translation exposure are the same thing.  
  
C.  
hedging one always involves increasing the other.  
  
D.  
hedging one might involve increasing the other.

B.  
accounting exposure and translation exposure are the same thing.

When exchange rates change  
  
  
A.  
the value of a foreign subsidiary's foreign currency denominated assets and liabilities change to new numbers still denominated in the foreign currency.  
  
B.  
the value of a foreign subsidiary's foreign currency denominated assets and liabilities change when redenominated into the home currency.  
  
C.  
hedging should be done after the change.  
  
D.  
none of the above

B.  
the value of a foreign subsidiary's foreign currency denominated assets and liabilities change when redenominated into the home currency.

Translation exposure measures  
  
  
A.  
the effect that an anticipated change in exchange rates will have on the consolidated financial reports of an MNC.  
  
B.  
economic exposure.  
  
C.  
the change in the value of a foreign subsidiaries assets and liabilities denominated in a foreign currency, as a result of exchange rate change fluctuations, when viewed from the perspective of the parent firm.  
  
D.  
all of the above

C.  
the change in the value of a foreign subsidiaries assets and liabilities denominated in a foreign currency, as a result of exchange rate change fluctuations, when viewed from the perspective of the parent firm.

The extent to which the value of the firm would be affected by expected changes in the exchange rate is  
  
  
A.  
transaction exposure.  
  
B.  
translation exposure.  
  
C.  
economic exposure.  
  
D.  
none of the above

D.  
none of the above

The current/noncurrent method of foreign currency translation was generally accepted in the United States from the 1930s until 1975, when  
  
  
A.  
FASB 2 became effective.  
  
B.  
FASB 4 became effective.  
  
C.  
FASB 6 became effective.  
  
D.  
FASB 8 became effective.

D.  
FASB 8 became effective.

The underlying principle of the current/noncurrent method is that assets and liabilities should be translated based on their maturity.  
  
  
A.  
Current assets and liabilities are converted at the current exchange rate in effect when the cash flow associated with the asset or liability actually occurred. Non-current assets and liabilities are translated at the historical exchange rate that prevailed when the asset was recognized.  
  
B.  
Current assets and liabilities, which by definition have a maturity of one year or less, are converted at the current exchange rate. Non-current assets and liabilities are translated at the historical exchange rate.  
  
C.  
All assets and liabilities are converted at the current exchange rate.  
  
D.  
None of the above

B.  
Current assets and liabilities, which by definition have a maturity of one year or less, are converted at the current exchange rate. Non-current assets and liabilities are translated at the historical exchange rate.

The generally accepted method for consolidating the financial reports of an MNC from the 1930s to 1975 was  
  
  
A.  
current/noncurrent method.  
  
B.  
monetary/nonmonetary method.  
  
C.  
temporal method.  
  
D.  
current rate method.

A.  
current/noncurrent method.

Under the current/noncurrent method  
  
A. a foreign subsidiary with current assets in excess of current liabilities will cause a translation gain (loss) if the local currency appreciates (depreciates).  
  
B. a foreign subsidiary with current assets in excess of current liabilities will cause a translation loss (gain) if the local currency appreciates (depreciates).  
  
C. a foreign subsidiary with current assets in excess of current liabilities will cause a translation gain (loss) if the local currency depreciates (appreciates).  
  
D. both b and c

A. a foreign subsidiary with current assets in excess of current liabilities will cause a translation gain (loss) if the local currency appreciates (depreciates).

When using the current/noncurrent method, current assets are defined as  
  
  
A.  
inventory that is currently salable.  
  
B.  
assets with a maturity of one year or less.  
  
C.  
assets with a maturity of 90 days or less.  
  
D.  
none of the above

B.  
assets with a maturity of one year or less.

When using the current/noncurrent method,  
  
  
A.  
most income statement items are translated at the average exchange rate for the accounting period.  
  
B.  
revenue and expense items that are associated with noncurrent assets or liabilities are translated at the historical rate that applies to the applicable balance sheet items.  
  
C.  
depreciation expense is translated at the historical rate that applies to the applicable depreciable asset items.  
  
D.  
all of the above

D.  
all of the above

Which of the following statements is false?  
  
  
A.  
Most income statement items under the current/noncurrent method are translated at the average exchange rate for the accounting period.  
  
B.  
Under the current/noncurrent method, revenue and expense items that are associated with current assets or liabilities, such as depreciation expense, are translated at the historical rate that applies to the applicable balance sheet item.  
  
C.  
Under the current/noncurrent method, revenue and expense items that are associated with noncurrent assets or liabilities, such as depreciation expense, are translated at the historical rate that applies to the applicable balance sheet item.  
  
D.  
Depreciation expense is translated at the historical rate that applies to the applicable depreciable asset items.

B.  
Under the current/noncurrent method, revenue and expense items that are associated with current assets or liabilities, such as depreciation expense, are translated at the historical rate that applies to the applicable balance sheet item.

The underlying principle of the current/noncurrent method is  
  
A.  
assets and liabilities should be translated based on their maturity.  
  
B.  
monetary balance sheet accounts should be translated at the spot rate; nonmonetary accounts are translated at the historical rate in effect when the account was first recorded.  
  
C.  
monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D.  
all balance sheet accounts are translated at the current exchange rate, except stockholder equity.

A.  
assets and liabilities should be translated based on their maturity.

The underlying principle of the current/noncurrent method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except for stockholders' equity. A "plug" equity account named cumulative translation adjustment (CTA) is used to make the balance sheet balance, since translation gains or losses do not go through the income statement according to this method.

A. assets and liabilities should be translated based on their maturity.

According to the monetary/nonmonetary method, monetary balance sheet accounts include  
  
A. for example, cash, marketable securities, accounts receivable, notes payable, accounts payable of a foreign subsidiary.  
  
B. for example stockholders' equity and long term debt.  
  
C.  
for example inventory paid for in cash, but not working capital.  
  
D.  
COGs, Sales, Net Income.

A. for example, cash, marketable securities, accounts receivable, notes payable, accounts payable of a foreign subsidiary.

The underlying philosophy of the monetary/nonmonetary method is that  
  
A. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation is independent of exchange rate changes.  
  
B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.  
  
C. assets and liabilities should be translated based on their maturity.  
  
D. most income statement items are translated at the average exchange rate for the period. Depreciation and cost of goods sold, however, are translated at historical rates if the associated balance sheet accounts are carried at historical costs.

B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.

In comparison to the current/noncurrent method, the monetary/nonmonetary method  
  
A. differs substantially with regard to the treatment of inventory.  
  
B. classifies accounts on the basis of similarity of attributes rather than the similarity of maturities.  
  
C. both a and b  
  
D. none of the above

C. both a and b

Under which accounting method are most income statement accounts are translated at the average exchange rate for the period?  
  
A. Current/noncurrent method  
  
B. Monetary/nonmonetary method  
  
C. Temporal method  
  
D. Current rate method

B. Monetary/non-monetary method

The underlying principle of the monetary/nonmonetary method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except for stockholders' equity. A "plug" equity account named cumulative translation adjustment (CTA) is used to make the balance sheet balance, since translation gains or losses do not go through the income statement according to this method.

B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.

Using the temporal method, monetary accounts such as cash  
  
A. are not translated.  
  
B. are translated at the average exchange rate prevailing over the reporting period.  
  
C. are translated at the current forward exchange rate.  
  
D. are translated at the current spot exchange rate.

D. are translated at the current spot exchange rate.

The underlying principle of the temporal method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary balance sheet accounts should be translated at the spot rate; nonmonetary accounts are translated at the historical rate in effect when the account was first recorded.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except stockholder equity.

C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.

Since fixed assets and inventory are usually carried at historical costs,  
  
A. the temporal method and the monetary/nonmonetary methods will typically provide the same translation.  
  
B. the current rate method and the monetary/nonmonetary methods will typically provide the same translation.  
  
C. the temporal method and the current/noncurrent methods will typically provide the same translation.  
  
D.  
none of the above

A. the temporal method and the monetary/nonmonetary methods will typically provide the same translation.

The underlying principle of the temporal method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except for stockholders' equity. A "plug" equity account named cumulative translation adjustment (CTA) is used to make the balance sheet balance, since translation gains or losses do not go through the income statement according to this method.

C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.

The underlying principle of the current rate method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary accounts have a similarity because their value represents a sum of money whose currency equivalent after translation changes each time the exchange rate changes.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except for stockholders' equity. A "plug" equity account named cumulative translation adjustment (CTA) is used to make the balance sheet balance, since translation gains or losses do not go through the income statement according to this method.

D. all balance sheet accounts are translated at the current exchange rate, except for stockholders' equity. A "plug" equity account named cumulative translation adjustment (CTA) is used to make the balance sheet balance, since translation gains or losses do not go through the income statement according to this method.

Under the current rate method,  
  
A. income statement items are to be translated at the exchange rate at the dates the items are recognized.  
  
B. since a is generally impractical, an appropriately weighted average exchange rate for the period may be used for translation.  
  
C. all balance sheet accounts are translated at the current exchange rate, except stockholder equity.  
  
D. all of the above

D. all of the above

Which of the following is a translation method where the gain or loss due to translation adjustment does not affect reported cash flows?  
  
A. Current/noncurrent method  
  
B. Current rate method  
  
C. Current/future method  
  
D. Short/long term method

B. Current rate method

The underlying principle of the current rate method is  
  
A. assets and liabilities should be translated based on their maturity.  
  
B. monetary balance sheet accounts should be translated at the spot rate; nonmonetary accounts are translated at the historical rate in effect when the account was first recorded.  
  
C. monetary accounts are translated at the current exchange rate; other accounts are translated at the current exchange rate if they are carried on the books at current value; items carried at historical cost are translated at historic exchange rates.  
  
D. all balance sheet accounts are translated at the current exchange rate, except stockholder equity.

D. all balance sheet accounts are translated at the current exchange rate, except stockholder equity.

The simplest of all translation methods to apply is  
  
A.  
current/noncurrent method.  
  
B.  
monetary/nonmonetary method.  
  
C.  
temporal method.  
  
D.  
current rate method.

D.  
current rate method.

Which of the following is a translation method where a "plug" equity account called cumulative translation adjustment is used?  
  
A. Current/noncurrent method  
  
B. Current rate method  
  
C. Current/future method  
  
D. Short/long term method

B. Current rate method

FASB 8 is essentially the  
  
A. current/noncurrent method.  
  
B. monetary/nonmonetary method.  
  
C. temporal method.  
  
D.  
current rate method.

C. temporal method.

FASB 8  
  
  
A.  
required taking foreign exchange gains or losses through the income statement.  
  
B.  
caused reported earnings to fluctuate substantially from year to year.  
  
C.  
ran into acceptance problems from the accounting profession and MNCs.  
  
D.  
all of the above

D.  
all of the above

FASB 52 requires  
  
  
A.  
the current rate method of translation in some circumstances and the temporal method in others.  
  
B.  
the current rate method of translation in some circumstances and the noncurrent method in others.  
  
C.  
the monetary rate method of translation in some circumstances and the temporal method in others.  
  
D.  
the current rate method of translation in some circumstances and the monetary method in others.

A.  
the current rate method of translation in some circumstances and the temporal method in others.

The International Accounting Standards Committee  
  
A. is now known as The International Accounting Standards Board.  
  
B. is charged with accounting standards at the International House of Pancakes.  
  
C. includes many convicted felons among its members.  
  
D. all of the above

A. is now known as The International Accounting Standards Board.

In what year were U.S. MNCs mandated to implement FASB 52?  
  
A. 1952  
  
B. 1962  
  
C. 1972  
  
D. 1982

D. 1982

The "functional currency" is defined in FASB 52 as  
  
  
A.  
the currency of the primary economic environment in which the entity operates.  
  
B.  
the currency in which the MNC prepares its consolidated financial statements.  
  
C.  
a currency that is not the parent firm's home country currency.  
  
D.  
both b and c

A.  
the currency of the primary economic environment in which the entity operates.

The "reporting currency" is defined in FASB 52 as  
  
  
A.  
the currency of the primary economic environment in which the entity operates.  
  
B.  
the currency in which the MNC prepares its consolidated financial statements.  
  
C.  
a currency that is not the parent firm's home country currency.  
  
D.  
both a and c

B.  
the currency in which the MNC prepares its consolidated financial statements.

The stated objectives of FASB 52 are  
  
  
A.  
to provide information that is generally compatible with the expected economic effects of a rate change on an enterprise's cash flows and equity.  
  
B.  
to reflect in consolidated statements the financial results and relationships of the individual consolidated entities as measured in their functional currencies in conformity with U.S. generally accepted accounting principles.  
  
C.  
both a and b  
  
D.  
none of the above

C.  
both a and b

The currency of the primary economic environment in which the entity operates is defined in FASB 52 as  
  
  
A.  
the "reporting currency".  
  
B.  
the "functional currency".  
  
C.  
the "current currency".  
  
D.  
none of the above

B.  
the "functional currency".

The actual translation process prescribed by FASB 52 is  
  
A. a two-stage process.  
  
B. a twelve step program.  
  
C. a five-step process.  
  
D. none of the above.

A. a two-stage process.

When determining the functional currency,  
  
A. if the sales prices for the foreign entity's products are generally not responsive on a short-term basis to exchange rate changes, but are determined more by local competition and government regulation, the local currency should be the functional currency.  
  
B. if there is an active local market for the foreign entity's products the local currency should be the functional currency.  
  
C. if factor of production costs for the foreign entity are primarily, and on a continuing basis, costs for components obtained from the parent's country the function currency should be the home currency.  
  
D. all of the above

D. all of the above

In implementing FASB 52,  
  
  
A. the functional currency of the foreign entity must be translated into the reporting currency in which the consolidated statements are reported.  
  
B. the local currency of a foreign entity may not always be its functional currency. If it is not, the temporal method of translation is used to remeasure the foreign entity's books into the functional currency.  
  
C. the current rate method is used to translate from the functional currency to the reporting currency.  
  
D. in some cases, a foreign entity's functional currency may be the same as the reporting currency, in which case translation is not necessary.  
  
E. All of the above are true

A. the functional currency of the foreign entity must be translated into the reporting currency in which the consolidated statements are reported.

A translation exposure report shows, for each account that is included in the consolidated balance sheet,  
  
A. the amount of foreign exchange exposure that exists for each foreign subsidiary in which the MNC has a material interest.  
  
B. the amount of foreign exchange exposure that exists on a net basis for the firm.  
  
C. the amount of foreign exchange exposure that exists for each foreign currency in which the MNC has exposure.  
  
D. none of the above

C. the amount of foreign exchange exposure that exists for each foreign currency in which the MNC has exposure.

Salient economic factors for determining the functional currency include  
  
  
A.  
cash flow indicators.  
  
B.  
sales price indicators.  
  
C.  
sales market indicators.  
  
D.  
all of the above

D.  
all of the above

The impact of financing in determining the functional currency  
  
A. financing does not impact the choice of functional currency due to the integrated nature of capital markets.  
  
B. if the financing of the foreign entity is primarily denominated in the foreign currency and the debt service obligations are normally handled by the foreign entity, the functional currency is the foreign currency.  
  
C. if the financing of the foreign entity is primarily from the parent, with debt service obligations are normally handled by the parent, the functional currency is the home currency.  
  
D. both b and c

D. both b and c

If a foreign entity is only a shell company for carrying accounts that could be carried on the parent's books,  
  
A. the functional currency would generally be the parent's currency.  
  
B. the functional currency would generally be the local currency.  
  
C. there is no reason to hedge transaction exposure.  
  
D. none of the above

A. the functional currency would generally be the parent's currency.

A highly inflationary economy is define in FASB 52 as  
  
  
A.  
one that has cumulative inflation of approximately 100 percent or more over a 3-year period.  
  
B.  
one that has current inflation of approximately 40 percent per year.  
  
C.  
one that has going-forward expected inflation of approximately 40 percent per year.  
  
D.  
none of the above

A.  
one that has cumulative inflation of approximately 100 percent or more over a 3-year period.

In highly inflationary economies, FASB 52 requires that the foreign entities financial statement be remeasured from the local currency "as if the functional currency were the reporting currency". The purpose of this requirement is  
  
A.  
to prevent large important balance sheet accounts, carried at historical values, from having insignificant values once translated into the reporting currency at the current rate.  
  
B.  
to prevent games playing in the accounting books.  
  
C.  
to prevent having to restate the books at a later date.  
  
D.  
none of the above

A. to prevent large important balance sheet accounts, carried at historical values, from having insignificant values once translated into the reporting currency at the current rate.

Which of the following are true?  
  
  
A.  
Some items that are a source of transaction exposure are also a source of translation exposure.  
  
B.  
Some items that are a source of transaction exposure are NOT also a source of translation exposure.  
  
C.  
Both a and b  
  
D.  
None of the above

C.  
Both a and b

Generally speaking,  
  
A. it is not possible to hedge both translation exposure and transaction exposure simultaneously.  
  
B. if a firm can hedge translation exposure then transaction exposure will be simultaneously hedged.  
  
C. if a firm can hedge transaction exposure then translation exposure will be simultaneously hedged.  
  
D. none of the above

A. it is not possible to hedge both translation exposure and transaction exposure simultaneously.

Translation exposure,  
  
  
A.  
  
is not entity specific, rather it is currency specific.  
  
  
  
B.  
  
is not currency specific, rather it is entity specific.  
  
  
  
C.  
  
involves restatement from Italian to French.  
  
  
  
D.  
  
none of the above

A.  
  
is not entity specific, rather it is currency specific.

The source of translation exposure  
  
A. is a mismatch of net assets and net liabilities denominated in the same currency.  
  
B. is a mismatch of net assets and net liabilities denominated in the different currencies.  
  
C. is a mismatch of current assets and current liabilities denominated in different currencies.  
  
D. none of the above

A. is a mismatch of net assets and net liabilities denominated in the same currency.

A balance sheet hedge seeks to  
  
  
A.  
eliminate any mismatch of net assets and net liabilities denominated in the same currency.  
  
B.  
transfer accounting exposure to transaction exposure.  
  
C.  
create cumulative translation adjustment.  
  
D.  
none of the above

A.  
eliminate any mismatch of net assets and net liabilities denominated in the same currency.

A derivatives hedge that seeks to eliminate translation exposure  
  
A.  
eliminate any mismatch of the rate of change in net assets and the rate of change in net liabilities denominated in the same currency.  
  
B.  
really involves speculation about foreign exchange rate changes.  
  
C.  
by simultaneously going long and short in currency futures contracts.  
  
D.  
none of the above

B. really involves speculation about foreign exchange rate changes.

With regard to translation exposure versus operating exposure  
  
  
A.  
upper management should be more concerned with translation exposure.  
  
B.  
any discussion really involves speculation about foreign exchange rate changes.  
  
C.  
upper management should be more concerned with operating exposure.  
  
D.  
none of the above

C.  
upper management should be more concerned with operating exposure.

With regard to research on the stock price reaction to mandated accounting changes such as FASB 52  
  
  
A.  
the results suggest that market participants seem to think that changes in reported earnings do not change the actual cash flows in multinational firms.  
  
B.  
the results suggest that market agents react to "cosmetic" earning changes.  
  
C.  
the results suggest that market agents do not react to cosmetic earning changes that do not affect value.  
  
D.  
none of the above

C.  
the results suggest that market agents do not react to cosmetic earning changes that do not affect value.

Which of the following are true statements?  
  
A. Since translation exposure does not have an immediate direct effect on operating cash flows, its control is relatively unimportant in comparison to transaction exposure, which involves potential real cash flow losses.  
  
B. Since it is generally not possible to eliminate both translation exposure and transaction exposure, it is more logical to effectively manage transaction exposure.  
  
C. Two ways to control translation risk are: a balance sheet hedge and a derivatives "hedge."  
  
D. All of the above are true statements

D. All of the above are true statements

Under which method does the gain or loss due to translation adjustment not affect reported cash flows, as it does with the other three translation methods?  
  
  
A.  
Current/noncurrent method  
  
B.  
Monetary/nonmonetary method  
  
C.  
Temporal method  
  
D.  
Current rate method

D.  
Current rate method

Under FASB 52, when a net translation exposure exists,  
  
  
A.  
a derivatives hedge is necessary to bring balance to the consolidated balance sheet after an exchange rate change.  
  
B.  
a money market hedge is necessary to bring balance to the consolidated balance sheet after an exchange rate change.  
  
C.  
a cumulative translation adjustment account is necessary to bring balance to the consolidated balance sheet after an exchange rate change.  
  
D.  
none of the above

C.  
a cumulative translation adjustment account is necessary to bring balance to the consolidated balance sheet after an exchange rate change.

With regard to foreign currency translation methods used by foreign MNCs,  
  
A. foreign currency translation methods are generally only used by U.S. based MNCs since foreign firms have a built in hedge by being foreign.  
  
  
B. are generally the same methods used by U.S.-based firms.  
  
C. are exactly the same methods used by U.S.-based firms since GAAP is GAAP.  
  
D. none of the above is true statements.

D. none of the above is true statements.

**Eun & Resnick 4e**

**CHAP 7 Futures and Options on Foreign Exchange**

Futures Contracts: Some Preliminaries

Currency Futures Markets

**International Finance in Practice:** CME Ramping Up FOREX Support, Targets OTC Business

Basic Currency Futures Relationships

Eurodollar Interest Rate Futures Contracts

Options Contracts: Some Preliminaries

Currency Options Markets

Currency Futures Options

Basic Option-Pricing Relationships at Expiration

American Option-Pricing Relationships

European Option-Pricing Relationships

Binomial Option-Pricing Model

European Option-Pricing Formula

Empirical Tests of Currency Options

Summary

**MINI CASE:** The Options Speculator

**Futures Contracts: Some Preliminaries**

1. A CME contract on €125,000 with September delivery
   1. Is an example of a forward contract
   2. Is an example of a futures contract
   3. Is an example of a put option
   4. Is an example of a call option

Answer: b)

Rationale: options trade on the CBOE

1. Yesterday, you entered into a futures contract to buy €62,500 at $1.20 per €. Suppose that the futures price closes today at $1.16. How much have you made/lost?
   1. Depends on your margin balance
   2. You have made $2,500.00
   3. You have lost $2,500.00
   4. You have neither made nor lost money, yet.

Answer: c)

Rationale: You have lost $0.04, 62,500 times for a total loss of $2,500 = $0.04/€ × €62,500

1. In reference to the futures market, a “speculator”
   1. attempts to profit from a change in the futures price
   2. wants to avoid price variation by locking in a purchase price of the underlying asset through a long position in the futures contract or a sales price through a short position in the futures contract
   3. stands ready to buy or sell contracts in unlimited quantity
   4. b) and c)

Answer: a)

1. Comparing “forward” and “futures” exchange contracts, we can say that:
   1. They are both “marked-to-market” daily.
   2. Their major difference is in the way the underlying asset is priced for future purchase or sale: futures settle daily and forwards settle at maturity.
   3. A futures contract is negotiated by open outcry between floor brokers or traders and is traded on organized exchanges, while forward contract is tailor-made by an international bank for its clients and is traded OTC.
   4. b) and c)

Answer: d)

1. Comparing “forward” and “futures” exchange contracts, we can say that
   1. Delivery of the underlying asset is seldom made in futures contracts
   2. Delivery of the underlying asset is usually made in forward contracts
   3. Delivery of the underlying asset is seldom made in either contract—they are typically cash settled at maturity.
   4. a) and b)
   5. a) and c).

Answer: d)

1. In which market does a clearinghouse serve as a third party to all transactions?
   1. Futures
   2. Forwards
   3. Swaps
   4. None of the above

Answer: a)

1. In the event of a default on one side of a futures trade,
   1. The clearing member stands in for the defaulting party
   2. The clearing member will seek restitution for the defaulting party
   3. If the default is on the short side, a randomly selected long contract will not get paid. That party will then have standing to initiate a civil suit against the defaulting short.
   4. a) and b)

Answer: d)

1. Yesterday, you entered into a futures contract to buy €62,500 at $1.20 per €. Your initial performance bond is $1,500 and your maintenance level is $500. At what settle price will you get a demand for additional funds to be posted?
   1. $1.2160 per €.
   2. $1.208 per €.
   3. $1.1920 per €.
   4. $1.1840 per €.

Answer: d)

Rationale: To get a margin call, you have to lose $1,000. That will happen when the price FALLS (since you’re buying euro) to $1.1840 per €:

[$1.20/ € – $1.1840 per €] × €62,500 = $1,000.

1. Yesterday, you entered into a futures contract to sell €62,500 at $1.20 per €. Your initial performance bond is $1,500 and your maintenance level is $500. At what settle price will you get a demand for additional funds to be posted?
   1. $1.2160 per €.
   2. $1.208 per €.
   3. $1.1920 per €.
   4. $1.1840 per €.

Answer: a)

Rationale: To get a margin call, you have to lose $1,000. That will happen when the price RISES (since you’re selling euro at $1.20 per €.) to $1.2160 per €:

[$1.2160/ € – $1.20 per €] × €62,500 = $1,000.

1. Three days ago, you entered into a futures contract to sell €62,500 at $1.20 per €. Over the past three days the contract has settled at $1.20, $1.22, and $1.24. How much have you made or lost?
   1. Lost $0.04 per € or $2,500
   2. Made $0.04 per € or $2,500
   3. Lost $0.06 per € or $3,750
   4. None of the above

Answer: a)

Rationale: Losses will happen when the price RISES (since you’re selling euro at $1.20 per €.) Total loss

[$1.20/ € – $1.24 per €] × €62,500 = –$2,500

**Currency Futures Markets**

1. Today’s settlement price on a Chicago Mercantile Exchange (CME) Yen futures contract is $0.8011/¥100. Your margin account currently has a balance of $2,000. The next three days’ settlement prices are $0.8057/¥100, $0.7996/¥100, and $0.7985/¥100. (The contractual size of one CME Yen contract is ¥12,500,000). If you have a short position in one futures contract, the changes in the margin account from daily marking-to-market will result in the balance of the margin account after the third day to be
   1. $1,425
   2. $2,000
   3. $2,325
   4. $3,425

Answer: c) not unlike Problem 1 at the end-of-chapter exercises

Rationale: $2,325 = $2,000 +

¥12,500,000×[(0.008011 – 0.008057) + (0.008057 – 0.007996) + (0.007996 – 0.007985)]

Please note that $0.8011/¥100 = $0.008011/¥ and $0.8057/¥100 = $0.008057/¥, etc.

1. Today’s settlement price on a Chicago Mercantile Exchange (CME) Yen futures contract is $0.8011/¥100. Your margin account currently has a balance of $2,000. The next three days’ settlement prices are $0.8057/¥100, $0.7996/¥100, and $0.7985/¥100. (The contractual size of one CME Yen contract is ¥12,500,000). If you have a long position in one futures contract, the changes in the margin account from daily marking-to-market, will result in the balance of the margin account after the third day to be:
   1. $1,425
   2. $1,675
   3. $2,000
   4. $3,425

Answer: b) not unlike Problem 1 at the end-of-chapter exercises

Rationale: $1,675 = $2,000 +

¥12,500,000×[(0.008057 - 0.008011) + (0.007996 – 0.008057) + (0.007985 – 0.007996)]

Please note that $0.8011/¥100 = $0.008011/¥ and $0.8057/¥100 = $0.008057/¥, etc.

**Basic Currency Futures Relationships**

1. Open interest in currency futures contracts
   1. Tends to be greatest for the near-term contracts
   2. Tends to be greatest for the longer-term contracts
   3. Typically decreases with the term to maturity of most futures contracts
   4. a) and c)

Answer: a)

1. The “open interest” shown in currency futures quotations is:
   1. the total number of people indicating interest in buying the contracts in the near future
   2. the total number of people indicating interest in selling the contracts in the near future
   3. the total number of people indicating interest in buying or selling the contracts in the near future
   4. the total number of long or short contracts outstanding for the particular delivery month

Answer: d)

**Eurodollar Interest Rate Futures Contracts**

1. The most widely used futures contract for hedging short-term U.S. dollar interest rate risk is:
   1. The Eurodollar contract
   2. The Euroyen contract
   3. The EURIBOR contract
   4. None of the above

Answer: a)

1. Consider the position of a treasurer of a MNC, who has $20,000,000 that his firm will not need for the next 90 days:
   1. He could borrow the $20,000,000 in the money market
   2. He could take a long position in the Eurodollar futures contract.
   3. He could take a short position in the Eurodollar futures contract
   4. None of the above

Answer: b)

1. A DECREASE in the implied three-month LIBOR yield causes Eurodollar futures price
   1. To increase
   2. To decrease
   3. There is no direct or indirect relationship
   4. None of the above

Answer: a)

**Options Contracts: Some Preliminaries**

1. If you think that the dollar is going to appreciate against the euro
   1. You should buy put options on the euro
   2. You should sell call options on the euro
   3. You should buy call options on the euro
   4. None of the above

Answer: c)

1. From the perspective of the writer of a put option written on €62,500. If the strike price is $1.25/€, and the option premium is $1,875, at what exchange rate do you start to lose money?
   1. $1.22/€
   2. $1.25/€
   3. $1.28/€
   4. None of the above

Answer: a)

Rationale: Per euro, the option premium is . Since it’s a put option, the writer loses money when the price goes down, thus he breaks even at $1.25/€ – $0.03/€ = $1.22/€

1. A European option is different from an American option in that
   1. One is traded in Europe and one in traded in the United States
   2. European options can only be exercised at maturity; American options can be exercised prior to maturity.
   3. European options tend to be worth more than American options, *ceteris paribus.*
   4. American options have a fixed exercise price; European options’ exercise price is set at the average price of the underlying asset during the life of the option.

Answer: b)

1. An “option” is(名词解释)
   1. a contract giving the seller (writer) the right, but not the obligation, to buy or sell a given quantity of an asset at a specified price at some time in the future
   2. a contract giving the owner (buyer) the right, but not the obligation, to buy or sell a given quantity of an asset at a specified price at some time in the future
   3. not a derivative, nor a contingent claim, security
   4. unlike a futures or forward contract

Answer: b)

1. An investor believes that the price of a stock, say IBM’s shares, will increase in the next 60 days. If the investor is correct, which combination of the following investment strategies will show a profit in all the choices?

(i) - buy the stock and hold it for 60 days

(ii) - buy a put option

(iii) - sell (write) a call option

(iv) - buy a call option

(v) - sell (write) a put option

* 1. (i), (ii), and (iii)
  2. (i), (ii), and (iv)
  3. (i), (iv), and (v)
  4. (ii) and (iii)

Answer: c)

**Currency Options Markets**

1. Most exchange traded currency options
   1. Mature every month, with daily resettlement.
   2. Have original maturities of 1, 2, and 3 years.
   3. Have original maturities of 3, 6, 9, and 12 months.
   4. Mature every month, withOUT daily resettlement

Answer: c)

1. The volume of OTC currency options trading is
   1. Much smaller than that of organized-exchange currency option trading.
   2. Much larger than that of organized-exchange currency option trading.
   3. Larger, because the exchanges are only repackaging OTC options for their customers
   4. None of the above

Answer: b)

1. In the CURRENCY TRADING section of *The Wall Street Journal*, the following appeared under the heading OPTIONS:

|  |  |  |
| --- | --- | --- |
| Philadelphia Exchange | | |
|  | Puts | |
| Swiss Franc |  | 69.33 |
| 62,500 Swiss Francs-cents per unit | Vol. | Last |
| 68 May | 12 | 0.30 |
| 69 May | 50 | 0.50 |

Which combination of the following statements are true?

(i)- The time values of the 68 May and 69 May put options are respectively .30 cents and .50 cents.

(ii)- The 68 May put option has a lower time value (price) than the 69 May put option.

(iii)- If everything else is kept constant, the spot price and the put premium are inversely related.

(iv)- The time values of the 68 May and 69 May put options are, respectively, 1.63 cents and 0.83 cents.

(v)- If everything else is kept constant, the strike price and the put premium are inversely related.

* 1. (i), (ii), and (iii)
  2. (ii), (iii), and (iv)
  3. (iii) and (iv)
  4. ( iv) and (v)

Answer: a)

# Rationale: Premium - Intrinsic Value = Time Value

68 May Put: 0.30 – Max[68 - 69.33, 0] = 0.30 cents

69 May Put: 0.50 – Max[69 - 69.33, 0] = 0.50 cents

**Currency Futures Options**

1. With currency futures options the underlying asset is
   1. Foreign currency
   2. A call or put option written on foreign currency
   3. A futures contract on the foreign currency
   4. None of the above

Answer: c)

1. Exercise of a currency futures option results in
   1. A long futures position for the call buyer or put writer
   2. A short futures position for the call buyer or put writer
   3. A long futures position for the put buyer or call writer
   4. A short futures position for the call buyer or put buyer

Answer: a)

1. A currency futures option amounts to a derivative on a derivative. Why would something like that exist?
   1. For some assets, the futures contract can have lower transactions costs and greater liquidity than the underlying asset
   2. Tax consequences matter as well, and for some users an option contract on a future is more tax efficient
   3. Transactions costs and liquidity.
   4. All of the above

Answer: d)

**Basic Option-Pricing Relationships at Expiration**

1. The current spot exchange rate is $1.25 = €1.00 and the three-month forward rate is $1.30 = €1.00. Consider a three-month American call option on €62,500. For this option to be considered at-the-money, the strike price must be:
   1. $1.30 = €1.00
   2. $1.25 = €1.00
   3. $1.25 × (1+*i*$)3/12 = €1.00 × (1+*i*€)3/12
   4. none of the above

Answer: b)

1. The current spot exchange rate is $1.25 = €1.00 and the three-month forward rate is $1.30 = €1.00. Consider a three-month American call option on €62,500 with a strike price of $1.20 = €1.00. Immediate exercise of this option will generate a profit of
   1. $6,125
   2. $6,125/(1+*i*$)3/12
   3. negative profit, so exercise would not occur
   4. $3,125

Answer: d)

Rationale: with early exercise, you can pay $1.20 for something worth $1.25. So you make a nickel. Make a nickel 62,500 times and you’ve made $3,125.

1. The current spot exchange rate is $1.25 = €1.00 and the three-month forward rate is $1.30 = €1.00. Consider a three-month American call option on €62,500 with a strike price of $1.20 = €1.00. If you pay an option premium of $5,000 to buy this call, at what exchange rate will you break-even?
   1. $1.28 = €1.00
   2. $1.32 = €1.00
   3. $1.20 = €1.00
   4. $1.38 = €1.00

Answer: a)

Rationale: A $5,000 option premium on €62,500 amounts to $0.08 per euro. With a strike price of $1.20 = €1.00 the exchange rate has to go to $1.28 = €1.00 for you to break even.

|  |  |
| --- | --- |
| 1. Consider the graph of a call option shown at right. The option is a three-month American call option on €62,500 with a strike price of $1.20 = €1.00 and an option premium of $3,125. What are the values of A, B, and C, respectively?    1. A = –$3,125 (or –$.05 depending on your scale); B = $1.20; C = $1.25    2. A = –€3,750 (or –€.06 depending on your scale); B = $1.20; C = $1.25    3. A = –$.05; B = $1.25; C = $1.30    4. none of the above   Answer: a) |  |
| 1. Which of the lines is a graph of the profit at maturity of writing a call option on €62,500 with a strike price of $1.20 = €1.00 and an option premium of $3,125?    1. A    2. B    3. C    4. D   Answer: b) |  |

**American Option-Pricing Relationships**

1. The current spot exchange rate is $1.25 = €1.00; the three-month U.S. dollar interest rate is 2%. Consider a three-month American call option on €62,500 with a strike price of $1.20 = €1.00. What is the least that this option should sell for?
   1. $0.05×62,500 = $3,125
   2. $3,125/1.02 = $3,063.73
   3. $0.00
   4. none of the above

Answer: a)

1. Which of the follow options strategies are consistent in their belief about the future behavior of the underlying asset price?
   1. selling calls and selling puts
   2. buying calls and buying puts
   3. buying calls and selling puts
   4. none of the above

Answer: c)

1. American call and put premiums
   1. Should be at least as large as their intrinsic value
   2. Should be at no larger than their moneyness
   3. Should be exactly equal to their time value
   4. Should be no larger than their speculative value

Answer: a)

1. Which of the following is correct?
   1. time value = intrinsic value + option premium
   2. intrinsic value = option premium + time value
   3. Option premium = intrinsic value – time value
   4. Option premium = intrinsic value + time value

Answer: d)

**European Option-Pricing Relationships**

1. Assume that the dollar-euro spot rate is $1.28 and the six-month forward rate is . The six-month U.S. dollar rate is 5% and the Eurodollar rate is 4%. The minimum price that a six-month American call option with a striking price of $1.25 should sell for in a rational market is:
   1. 0 cents
   2. 3.47 cents
   3. 3.55 cents
   4. 3 cents

Answer: c) footnote 3



Rationale: Ca ≥ Max[(*St - E*), (*F - E*)/(1+*r*$), 0],

Ca ≥ Max[($1.28 – $1.25), ($1.2864 – $1.25)/1.05½ , 0] = 3.55 cents[[1]](#footnote-1)

1. For European options, what of the effect of an *increase* in *St*?
   1. Decrease the value of calls and puts *ceteris paribus*
   2. Increase the value of calls and puts *ceteris paribus*
   3. Decrease the value of calls, increase the value of puts *ceteris paribus*
   4. Increase the value of calls, decrease the value of puts *ceteris paribus*

Answer: d)

|  |  |
| --- | --- |
| 1. For an American call option, A and B in the graph are    1. Time value and intrinsic value    2. Intrinsic value and time value    3. In-the-money and out-of-the money    4. None of the above   Answer: b)  Rationale: Exhibit 7.10 |  |

1. For European options, what of the effect of an *increase* in *E*?
   1. Decrease the value of calls and puts *ceteris paribus*
   2. Increase the value of calls and puts *ceteris paribus*
   3. Decrease the value of calls, increase the value of puts *ceteris paribus*
   4. Increase the value of calls, decrease the value of puts *ceteris paribus*

Answer: c)

1. For European currency options written on euro with a strike price in dollars, what of the effect of an *increase* in *r*$ relative to *r*€?
   1. Decrease the value of calls and puts *ceteris paribus*
   2. Increase the value of calls and puts *ceteris paribus*
   3. Decrease the value of calls, increase the value of puts *ceteris paribus*
   4. Increase the value of calls, decrease the value of puts *ceteris paribus*

Answer: d)

1. For European currency options written on euro with a strike price in dollars, what of the effect of an *increase* in *r*$?
   1. Decrease the value of calls and puts *ceteris paribus*
   2. Increase the value of calls and puts *ceteris paribus*
   3. Decrease the value of calls, increase the value of puts *ceteris paribus*
   4. Increase the value of calls, decrease the value of puts *ceteris paribus*

Answer: d)

1. For European currency options written on euro with a strike price in dollars, what of the effect of an *increase* *r*€?
   1. Decrease the value of calls and puts *ceteris paribus*
   2. Increase the value of calls and puts *ceteris paribus*
   3. Decrease the value of calls, increase the value of puts *ceteris paribus*
   4. Increase the value of calls, decrease the value of puts *ceteris paribus*

Answer: c)

**Binomial Option-Pricing Model**

1. The hedge ratio
   1. Is the size of the long (short) position the investor must have in the underlying asset per option the investor must write (buy) to have a risk-free offsetting investment that will result in the investor perfectly hedging the option.
   2. 
   3. Is related to the number of options that an investor can write without unlimited loss while holding a certain number of shares.
   4. All of the above.

Answer: d)

Rationale: a) and b) are straight out of the book; c) is true (it’s also a pretty mild statement) but not explicitly stated in the book, but a good student would know that if a) and b) are true, then the right answer must be d).

|  |  |
| --- | --- |
| 1. Find the value of a call option written on €100 with a strike price of $1.00 = €1.00. In one period there are only two possibilities: the exchange rate will move up by 15% or down by 15% (i.e. $1.15 = €1.00 or $0.85 = €1.00). The U.S. risk-free rate is 5% over the period. The risk-neutral probability of a dollar depreciation is 2/3 and the risk-neutral probability of the dollar strengthening is 1/3. |  |

* 1. $9.5238
  2. $0.0952
  3. $0
  4. $3.1746

Answer: a)

Rationale:

Equation 9.10: 

**European Option-Pricing Formula**

1. Find the input *d*1 of the Black-Scholes price of a six-month call option written on €100,000 with a strike price of $1.00 = €1.00. The current exchange rate is $1.25 = €1.00; The U.S. risk-free rate is 5% over the period and the euro-zone risk-free rate is 4%. The volatility of the underlying asset is 10.7 percent.
   1. *d*1 = 0.103915
   2. *d*1 = 2.9871
   3. *d*1 = –0.0283
   4. none of the above

Answer: a)

Rationale: 



1. Find the Black-Scholes price of a six-month call option written on €100,000 with a strike price of $1.00 = €1.00. The current exchange rate is $1.25 = €1.00; The U.S. risk-free rate is 5% over the period and the euro-zone risk-free rate is 4%. The volatility of the underlying asset is 10.7 percent.
   1. *Ce* = $0.63577
   2. *Ce* = $0.0998
   3. *Ce* = $1.6331
   4. none of the above

Answer: a)

Rationale: 



**NOTE THAT YOU WILL HAVE TO PROVIDE YOUR STUDENTS WITH A TABLE OF THE NORMAL DISTRIBUTION.**

1. The Black-Scholes option pricing formula
   1. Are used widely in practice, especially by international banks in trading OTC options.
   2. Are not widely used outside of the academic world.
   3. Work well enough, but are not used in the real world because no one has the time to flog their calculator for five minutes on the trading floor.
   4. None of the above.

Answer: a)

**Empirical Tests of Currency Options**

1. Empirical tests of the Black-Scholes option pricing formula
   1. Shows that binomial option pricing is used widely in practice, especially by international banks in trading OTC options.
   2. Works well for pricing American currency options that are *at*-*the-money* or *out-of-the-money*.
   3. Does not do well in pricing *in-the-money* calls and puts.
   4. b) and c)

Answer: d)

1. You might consider partial credit for answer b), it is found by

   Ca ≥ Max[($1.28 – $1.25), ($1.2864 – $1.25)/1.05 , 0] = 3.47 cents [↑](#footnote-ref-1)