Chapter 12 Assignment

D 1. When Canada sells BlackBerrys to the United States, what effect does that have on the U.S.?
   a. U.S. net exports increase, and U.S. net capital outflow increases.
   b. U.S. net exports increase, and U.S. net capital outflow decreases.
   c. U.S. net exports decrease , and U.S. net capital outflow increases.
   d. U.S. net exports decrease, and U.S. net capital outflow decreases.

C 2. If a country has $50 million of net exports and $70 million of saving, net capital outflow and domestic investment must be which of the following?
   a. Net capital outflow is $50 million, and domestic investment is $70 million.
   b. Net capital outflow is $120 million, and domestic investment is $70 million.
   c. Net capital outflow is $50 million, and domestic investment is $20 million.
   d. Net capital outflow is $120 million, and domestic investment is $50 million.

D 3. If the exchange rate changes from 180 yen per dollar to 120 yen per dollar, the dollar does which of the following?
   a. It appreciates and so buys more Japanese goods.
   b. It appreciates and so buys fewer Japanese goods.
   c. It depreciates and so buys more Japanese goods.
   d. It depreciates and so buys fewer Japanese goods.

C 4. The nominal exchange rate is the price of what?
   a. foreign goods in a country
   b. a country's exports in the foreign country
   c. one currency in terms of another currency
   d. one good in terms of another good

D 5. Which of the following occurs when a currency appreciates?
   a. Prices in that country fall.
   b. Prices in that country rise.
   c. Currency buys fewer units of another currency.
   d. Currency buys more units of another currency.

C 6. Which of the following best describes the term trade deficit?
   a. an excess of government spending over tax collections
   b. an excess of exports over imports
   c. an excess of imports over exports
   d. an excess of supply over demand

D 7. Which of the following best characterizes an open economy?
   a. Occurring in a developed nation that is growing.
   b. It effectively prevents imports.
   c. Occuring where the population is growing rapidly due to immigration.
   d. It interacts freely with other economies around the world.

D 8. Suppose that a German-produced car becomes very popular in Canada. This would tend to do which of the following?
   a. affect Canadian net exports but not the trade balance
   b. reduce any existing balance of trade deficit in Canada
   c. increase a trade surplus in Canada
   d. increase a trade deficit in Canada

B 9. Which of the following is a limitation of the purchasing-power parity theory?
   a. Goods are generally homogenous in nature.
   b. Many goods are not traded.
   c. Relative changes in price levels tend to be identical across industrial nations.
   d. All goods are traded at some point in time.

D 10. Which of the following terms is used to describe the rate at which one country's currency can be traded for another's?
   a. the interest rate
   b. the inflation rate
   c. special drawing rights
   d. the nominal exchange rate

D 11. If one Japanese yen equals $.0094, how many yen can be purchased with $1.00?
   a. 9.4
   b. 10.638
   c. 94.00
   d. 106.38

B 12. Suppose we have a hypothetical two-country world, Canada and Japan. Also, suppose that fish is the only product for export between the two countries, and that fish is homogeneous. Assume the price for fish in Canada is $4.00 per pound and is 500 yen per pound in Japan. What is the nominal exchange rate between Canada and Japan?
   a. $1 = 500 yen
   b. $1 = 125 yen
   c. $1 = 100 yen
   d. $1 = 50 yen

B 13. The acquisition of foreign assets by domestic residents minus the acquisition of domestic assets by foreigners is called which of the following?
   a. the balance of trade
   b. net foreign investment
   c. the real exchange rate
   d. purchasing-power parity

True or False?

F 14. The value of a nation's imports minus the value of its exports is called net exports.

T 15. The value of a nation's exports minus the value of its imports, also called net exports, is a nation's trade balance.

T 16. The value of a nation's net capital outflows always equals the value of its net exports.

T 17. The economy's gross domestic product is divided among four components: consumption, investment, government purchases, and net exports.

F 18. Purchasing power parity is a theory of exchange rates that states that a unit of any given currency is always equal to a unit of another country's currency.

19. What are the six factors that influence a country's net exports?

(1) Consumer preferences on domestic v.s. foreign G&S
(2) Transporting costs
(3) Exchange rate
(4) price at home vs foreign countries
(5) Gov't policies towards foreign trade
(6) Income of consumers at home vs foreign

20. What are the four variables that influence capital outflows?

① Real interest rate being paid on foreign assets
② Real interest rate being paid on domestic assets
③ Perceived economic & political risks of holding asset abroad
④ Gov't policies that affect foreign ownership of domestic assets.

21. What is the difference between real and nominal exchange rates?

E: the rate at which a person can trade the currency of one country for the currency of another.
e: the rate at which a person can trade the G&S of a country for the G&S of another

$$e = \frac{EP}{P^*}$$

22. Use the following information to calculate the real exchange rate between Canada and Mexico.

Price of Mexican corn = 50 pesos/tonne
Price of Canadian corn = \$10/tonne
Nominal exchange rate: \$1 = 10 pesos

$$e = \frac{EP}{P^*} = \frac{10 \text{ pesos}/\$ \times \$10/\text{tonne}}{50 \text{ pesos}/\text{tonne}} = 2$$

1 Canadian corn can exchange for 2 Mexican corns.

23. What is purchasing-power parity?

PPP: A unit of any given currency should be able to buy the same amount of goods in all countries

24. Suppose that the Canadian dollar exchange rate is 0.4273 British pounds per dollar. Since the base year, inflation has been 2 percent in Canada and 4 percent in Britain. What is the real exchange rate? In real terms, has the dollar appreciated or depreciated against the pound? *Hint: remember that the price index is 100 in the base year. If there has been 2% inflation the new price index would be 102.*

$$e = \frac{EP}{P^*} = \frac{0.4273 \text{ £/\$} \times 102}{104} \doteq 0.42$$

In real term, the \$ has appreciated against £.

25. Molson's Beer is produced in Canada and sold in many countries. In the province of Ontario a six-pack of Molson's beer sold for \$8.75 Canadian. Across the border in Michigan, a six pack of the same beer was for sale for \$5.19 U.S. At the time, the exchange rate was \$0.67 U.S. = \$1.00 Canadian.

a. How much would it cost in U.S. currency to buy the beer in Ontario?

$$\$8.75 \text{ CAD} \times \frac{\$0.67 \text{ US}}{\text{CAD}} = \$5.8625 \text{ USD}$$

b. How much would it cost in Canadian currency to buy the beer in Michigan?

$$\$5.19 \text{ USD} / \$0.67 \text{ USD/CAD} = \$7.75 \text{ CAD}$$

c. Is there an arbitrage opportunity?

Yes, b/c after taking exchange into consideration, the prices of the beer are not the same in 2 countries.

d. If there is an arbitrage opportunity, where would you buy and where would you sell? How much profit could you expect on a six-pack?

I should buy beer in Michigan & sell it in Ontario.

profit = \$8.75 CAD − \$7.75 CAD = \$1 CAD.

26. Assuming all other things equal, what would happen to the Canadian dollar real exchange rate under each of the following circumstances?

a. The Canadian nominal exchange rate depreciates.

$e = EP/P^*$, if $E\downarrow$, $e\downarrow$.

b. Canadian domestic prices increase.

$e = EP/P^*$, $P\uparrow$, $e\uparrow$

c. Prices in the rest of the world rise.

$e = EP/P^*$, $P^*\uparrow$, $e\downarrow$