

**LO.a: Define an exchange rate, and distinguish between nominal and real exchange rates and spot and forward exchange rates.**

1. Consider an exchange rate quote of 1.5062 USD/EUR. Which of the following statements is *most* accurate?
  - A. USD is the price currency and EUR is the base currency. One EUR equals to 1.5062 USD.
  - B. EUR is the price currency and USD is the base currency. One USD equals to 1.5062 EUR.
  - C. USD is the price currency and EUR is the base currency. One USD equals to 1.5062 EUR.
2. Assume that the nominal spot exchange rate (USD/EUR) increases by 7.2%, the Eurozone price level decreases by 3%, and the U.S. price level increases by 2%. The change in the real exchange rate (%) is *closest* to:
  - A. 0.21%.
  - B. 1.94%.
  - C. -2.52%.
3. A US firm exports goods to Japan. The company receives payments in JPY after a credit period of 60 days. To reduce its foreign exchange risk, the US firm will *most likely* initiate a:
  - A. spot transaction.
  - B. forward contract.
  - C. real exchange rate contract.
4. An increase in the real exchange rate (quoted in terms of domestic currency per unit of foreign currency) is *most likely* to be associated with a decrease in which of the following?
  - A. Foreign price level.
  - B. Domestic price level.
  - C. Nominal exchange rate.
5. The base period CPI is 100 for US and India and the current exchange rate is 62 INR/USD. After two years, the exchange rate is 65 INR/USD. The CPI in US is 105 and in India it is 109. The real exchange rate is *closest* to:
  - A. 62.61 INR/USD.
  - B. 67.48 INR/USD.
  - C. 69.20 INR/USD.
6. Which of the following statements is *most likely* correct about currency exchange rates?
  - A. An exchange rate is the number of units of base currency that one unit of a price currency will buy.
  - B. A decline in USD/Euro means that USD is appreciating against the Euro.
  - C. The theory of purchasing power parity (PPP) describes the long term equilibrium of real exchange rates.

7. Which of the following is *least likely* to be the reason for why purchasing power parity does not hold?
- A. Each country has its own method to determine the real exchange rate.
  - B. Many goods and services are not traded internationally.
  - C. There are trade barriers and transaction costs.
8. The following data is given: the nominal spot exchange rate for PKR/AUD is 28, the consumer price index in Pakistan is 108 and the consumer price index in Australia is 101. The real PKR/AUD exchange rate is *closest* to:
- A. 26.
  - B. 28.
  - C. 30.
9. As the spot USD/GBP exchange rate decreases, which of the following is *most likely* to happen?
- A. USD depreciates against the GBP.
  - B. The purchasing power of a UK client increases.
  - C. The real exchange rate, USD/GBP, reduces.
10. Which of the following statements is/are *most likely* correct?
- Statement I: Forward contracts trade in OTC markets, while futures contracts trade on exchanges.
- Statement II: Forward contracts are only available for fixed contract amounts and fixed settlement dates.
- Statement III: Forward contracts offer more flexibility relative to futures contracts.
- A. Statements I and II.
  - B. Statements I and III.
  - C. Statements I, II, and III.

**LO.b: Describe the functions of and participants in the foreign exchange market.**

11. Which of the following is *least likely* a buy side foreign exchange market participant?
- A. Corporations.
  - B. Governments.
  - C. Multinational banks.
12. In order to minimize the foreign exchange exposure on a dollar-denominated receivable due from an American company in 200 days, a Chinese company would *most likely*:
- A. sell USD spot.
  - B. buy USD forward
  - C. sell USD forward.
13. A European investor wants to invest in risk free, one-year, USD-denominated zero coupon bonds. Over a one-year horizon, the exchange rate risk for the investment is determined by uncertainty over:
- A. USD/EUR spot rate one year from now.

- B. USD/EUR forward rate one year from now.
- C. USD/EUR forward rate today.

14. Which of the following statements is *least likely* to be true?
- A. A central bank intervenes in the FX market to manage the country's FX reserves.
  - B. A central bank intervenes in the FX market when FX markets become dysfunctional and corporations cannot conduct FX transactions.
  - C. A central bank intervenes in the FX market when the domestic currency becomes weak and it undercuts the country's export competitiveness.

**LO.c: Calculate and interpret the percentage change in a currency relative to another currency.**

15. A decrease in the USD/EUR exchange rate from 1.44 to 1.42 represents a (n):
- A. appreciation of EUR relative to USD of 1.39%.
  - B. depreciation of EUR relative to USD of 1.39%.
  - C. depreciation of USD relative to EUR of 1.39%.
16. A decrease in the USD/EUR exchange rate from 1.44 to 1.42 represents a change of USD relative to EUR of:
- A. -1.41%.
  - B. 1.39%.
  - C. 1.41%.
17. If the domestic currency depreciates, the direct exchange rate quote will *most likely*:
- A. increase.
  - B. decrease.
  - C. remain the same.
18. A Chicago-based dealer provides a spot exchange rate quote of 4.5640 GBP/USD to a client in UK. Which of the following is *most likely* to be correct from the perspective of a UK client?
- A. The indirect exchange rate quotation is 4.5640.
  - B. The direct exchange rate quotation is 4.5640.
  - C. The direct exchange rate quotation is 0.2191.
19. A dealer gives the following quote for PKR/IND: 1.1228 – 1.1236. What is the bid-offer quote in IND/PKR terms?
- A. 0.8906 – 0.8900.
  - B. 0.8900 – 0.8906.
  - C. 0.8902 – 0.8902.

**LO.d: Calculate and interpret currency cross-rates.**

20. In early 2014, a European traveler returned from India with INR5,000. A foreign exchange dealer provided the traveler with the following quotes:

Ratio	Spot Rates
USD/INR	0.0167
EUR/USD	0.9392
USD: US Dollar	

The amount of Euros (EUR) that the traveler would receive for INR 5,000 is *closest* to:

- A. 65.
- B. 78.
- C. 82.

21. A report produced by a dealer includes the following exchange rates:

	Spot Rate	Expected Spot Rate in One Year
USD/EUR	1.285	1.275
USD/CAD	1.122	1.141
EUR/GBP	1.174	1.168

The *most* accurate calculation of the expected depreciation (%) of the British pound (GBP) relative to the Canadian dollar (CAD) is:

- A. 0.5%.
- B. 2.9%.
- C. 2.1%.

22. If the MXN/USD quote is 12.3 and the USD/EUR quote is 1.45, then the MXN/EUR cross rate is *closest* to:

- A. 17.83.
- B. 8.48.
- C. 0.11.

23. The table below shows the spot exchange rates.

	Spot Rate
USD/EUR	1.5602
MXN/USD	2.0880
MXN/GBP	2.1097

Which of the following is *most likely* to be the spot USD/GBP cross-rate?

- A. 0.9897.
- B. 1.0104.
- C. 1.4107.

**LO.e: Convert forward quotations expressed on a points basis or in percentage terms into an outright forward quotation.**

24. The current spot rate for the USD/EUR is 0.7400. The forward rate for the EUR/Australian dollar (AUD) is 1.3300, which represents a 300 point forward premium to the spot rate (scaled up by four decimal places). The USD/AUD spot rate is *closest* to:

- A. 0.8842.
- B. 0.9620.

- C. 1.0142.
25. A forward exchange rate quote of +26.8 points when the USD/EUR spot rate is 1.3047 means that the forward exchange rate is *closest* to:
- A. 1.3020 USD/EUR.
  - B. 1.3074 USD/EUR.
  - C. 1.3095 USD/EUR.
26. A forward exchange rate quote of +1.576% when the USD/EUR spot rate is 1.3047 means that the forward exchange rate is *closest* to:
- A. 1.3124 USD/EUR.
  - B. 1.3205 USD/EUR.
  - C. 1.3253 USD/EUR.
27. A dealer quotes a CAD/USD spot rate to be 1.1468. Given that the 6-month forward rate is 1.1527, the 6-month forward points are *most likely* to be:
- A. -59.
  - B. +51.
  - C. +59.
28. A dealer quotes a three month forward exchange rate for ZAR/SEK at 1.1430. He also quotes the 3-month forward premium in percentage terms at 7.2%. Which of the following is *most likely* to be ZAR/SEK spot rate?
- A. 1.061.
  - B. 1.066.
  - C. 1.225.

**LO.f: Explain the arbitrage relationship between spot rates, forward rates, and interest rates.**

29. The JPY/AUD spot exchange rate is 81.31, the JPY interest rate is 0.14%, and the AUD interest rate is 4.84%. If the interest rates are quoted on the basis of a 360-day year, the 360 day JPY/AUD forward rate would be *closest* to:
- A. 77.66.
  - B. 79.56.
  - C. 81.48.
30. The JPY/AUD spot exchange rate is 81.31, the JPY interest rate is 0.14%, and the AUD interest rate is 4.84%. If the interest rates are quoted on the basis of a 360-day year, the 90-day JPY/AUD forward rate would be *closest* to:
- A. 77.66.
  - B. 79.56.
  - C. 80.37.

31. If the 270-day Libor rates (annualized) for the EUR and GBP are 1.260% and 1.214%, respectively, and the spot GBP/EUR exchange rate is 0.7378, then the 270-day forward rate ( $F_{\text{GBP/EUR}}$ ) is *closest* to:
- 0.7312.
  - 0.7375.
  - 0.7434.

**LO.g: Calculate and interpret a forward discount or premium.**

32. The base currency will trade at a forward premium if:
- the interest rate in the price currency is higher than the interest rate in the base currency.
  - the interest rate in the base currency is higher than the interest rate in the price currency.
  - the interest rate in the price currency is equal to the interest rate in the base currency.
33. The base currency will trade at forward discount if:
- the interest rate in the price currency is higher than the interest rate in the base currency.
  - the interest rate in the base currency is higher than the interest rate in the price currency.
  - the interest rate in the price currency is equal to the interest rate in the base currency.
34. Which of the following is *least likely* to be correct?
- The base currency is said to be trading at a forward premium if the forward points are positive.
  - The base currency is said to be trading at a forward premium if the forward rate is above the spot rate.
  - The base currency is said to be trading at a forward premium if it is the currency with the higher interest rate.

**LO.h: Calculate and interpret the forward rate consistent with the spot rate and the interest rate in each currency.**

35. In early 2014, the British pound (GBP) to New Zealand dollar (NZD) spot exchange rate was 2.1986. LIBOR interest rates, quoted on a 360-day year basis, were 1.5051% for the British pound and 3.8085% for the New Zealand dollar. The 180-day forward points (scaled up by four decimal places) in GBP/NZD would be *closest* to:
- 248.0.
  - 168.0.
  - 165.0.

36. An investor examines the following rate quotes for the Thailand Bhat and the Indian Rupee.

Spot rate INR/THB	2.1026	INR 1-year interest rate	4.6%
Forward rate INR/THB	2.1287	THB 1-year interest rate	3.5%

If the investor shorts INR500,000 he will achieve a risk-free arbitrage profit (in INR) *closest* to:

- 856.

- B. 924.
- C. 1035.

37. The exchange rate for CDF/IND is 10.2562. The one year risk-less interest rate in CDF is 9%. What is the risk-less interest rate in IND if the no arbitrage one year forward rate is 10.4479?
- A. 7%.
  - B. 10%.
  - C. 5%.

**The following information is to be used for questions 38-39**

The following table provides information about an exchange rate as well as interest rates.

JPY/GBP spot exchange rate	66.45
JPY interest rate	0.42%
GBP interest rate	5.88%

Assume that the interest rates are quoted on the basis of a 360-day year.

38. The 90-day forward exchange rate JPY/GBP is *most likely* to be:
- A. 65.56.
  - B. 66.31.
  - C. 67.37.
39. The 90-day forward points in JPY/GBP are *most likely* to be:
- A. -89.
  - B. -14.
  - C. +92.

**LO.i: Describe exchange rate regimes.**

40. Which of the following statements about a currency board system (CBS) is *most* accurate?
- A. A CBS has a discretionary target level of foreign exchange reserves.
  - B. A CBS can peg to a basket of currencies, but a fixed-rate system cannot.
  - C. The monetary authority within a CBS does not act as a traditional lender of last resort.
41. Based solely on the exchange rate risk, what is the correct ranking (from most to least risky) of the following exchange rate regimes?
- A. Dollarization, Floating exchange rate, Currency board.
  - B. Floating exchange rate, Currency board, Dollarization.
  - C. Currency board, Dollarization, Floating exchange rate.
42. Which of the following exchange rate regimes is *least likely* to import inflation or deflation from the target currency?
- A. Floating exchange rate.
  - B. Dollarization.
  - C. Currency board.

43. Which of the following statements about exchange rate regimes is *most likely* correct?
- A. In dollarization, unlike in the currency board system, the monetary authority can earn a profit by paying little or no interest on its liability and can earn a market rate on its asset.
  - B. A target zone regime has a floating parity with horizontal intervention bands that can be adjusted.
  - C. Dirty floating invites trading partners to respond likewise with their exchange rate policy and potentially decreases stability in foreign exchange markets as a whole.

**LO.j: Explain the effects of exchange rates on countries' international trade and capital flows.**

44. An analyst uses the following data to estimate the effects of the changes in the INR exchange rate on India's balance of trade.

	Volume (INR billions)	Demand elasticity
Exports	250	0.7
Imports	300	0.9

A depreciation of the INR will *most likely*:

- A. reduce the trade deficit.
- B. increase the trade deficit.
- C. have no effect on the trade deficit.

45. An analyst uses the following data to estimate the effects of the changes in the THB exchange rate on Thailand's balance of trade.

	Volume (THB billions)	Demand elasticity
Exports	250	0.2
Imports	300	0.3

A depreciation of the THB will *most likely*:

- A. reduce the trade deficit
- B. increase the trade deficit.
- C. have no effect on the trade deficit.

46. The J-curve effect refers to the fact that a depreciation of the domestic currency:
- A. may increase a trade deficit in the short run even though it will eventually reduce the trade deficit.
  - B. may decrease a trade deficit in the short run even though it will eventually increase the trade deficit.
  - C. may increase a trade deficit in the short run even though it will have no effect in the long run.



## Solutions

1. A is correct. In case of an exchange rate quote of 1.5062 USD/EUR, USD is the price currency and EUR is the base currency. 1 EUR equals to 1.5062 USD.
2. B is correct. Here EUR is the base currency. The real exchange rate = nominal exchange rate \* price level in EUR / price level in USD. Assume that initially the nominal exchange rate = 1, the price level in EUR = 1 and the price level in USD = 1. Hence the real exchange rate = 1. After the changes the real exchange rate =  $[(1 + 0.072) * (1 - 0.03)] / (1 + 0.02) = 1.0194$ . This represents a change of 1.94% relative to the initial value of 1.
3. B is correct. To reduce its foreign exchange risk, the US firm will initiate a forward contract to sell JPY at an exchange rate agreed today.
4. B is correct.  
Real exchange rate = Nominal spot exchange rate \* CPI of the foreign country / CPI of the domestic country  
As the domestic price level decreases, the real exchange rate increases.
5. A is correct. Real exchange rate = (Nominal exchange rate) \*  $\left(\frac{CPI_{\text{foreign}}}{CPI_{\text{domestic}}}\right)$   
 $= 65 * \left(\frac{105}{109}\right) = 62.61$
6. B is correct. A is incorrect because an exchange rate is the number of units of price currency that one unit of the base currency will buy. C is incorrect because the theory of purchasing power parity (PPP) describes the long term equilibrium of nominal exchange rates.
7. A is correct. Purchasing power parity is not concerned with real exchange rates.
8. A is correct.  
Real Exchange Rate =  $(\text{Spot rate})_{p/b} * \frac{CPI_b}{CPI_p} = 28 * \frac{101}{108} = 26.18$
9. C is correct. As the spot USD/GBP exchange rate decreases, USD appreciates against the GBP, the purchasing power of a US client increases, and the real USD/GBP exchange rate reduces.
10. B is correct. Statement I and III are correct. Statement II is incorrect because forward contracts can be of any size and settlement date that the two counterparties agree upon.
11. C is correct. Multinational banks are sell side market participants.
12. C is correct. The receivable is due in 200 days. To reduce the risk of currency exposure, the Chinese company would initiate a forward contract to sell dollars at an exchange rate agreed to today.

13. A is correct. Exchange rate risk is defined by the uncertainty over future spot rates.
14. C is correct. The correct statement is ‘The central bank intervenes in the FX market when the domestic currency becomes so strong that it undercuts the country’s export competitiveness’.
15. B is correct. A decrease in the USD/EUR exchange rate represents a depreciation of the EUR by  $1.42/1.44 - 1 = -0.0139$ .
16. C is correct. To calculate the appreciation of USD, we first convert the quotes to EUR/USD. The initial rate becomes  $1/1.44 = 0.6944$  EUR/USD and later the rate becomes  $1/1.42 = 0.7042$  EUR/USD. The change in value of USD =  $0.7042/0.6944 - 1 = 0.0141$ .
17. A is correct. In the case of a direct exchange rate, the domestic currency is the price currency (the numerator) and the foreign currency is the base currency (the denominator). If the domestic currency depreciates, then the exchange rate (domestic per foreign) increases.
18. B is correct. The direct exchange rate quotation uses the domestic currency as the price currency and the foreign currency as the base currency. So, for a UK client a direct quote will have USD as the base currency and GBP as the price currency.
19. B is correct. The IND/PKR bid is the reciprocal of the PKR/IND offer:  $1/1.1236 = 0.8900$ . The IND/PKR offer is the reciprocal of the PKR/IND bid:  $1/1.1228 = 0.8906$ . Note that the bid always has to be lower than the offer.
20. B is correct.  
 The EUR/INR cross rate =  $\frac{\text{EUR}}{\text{USD}} * \frac{\text{USD}}{\text{INR}} = 0.9392 * 0.0167 = 0.0157$ .  
 The traveler will receive 0.0157 EUR per INR;  $0.0157 * 5,000 = 78.5$  EUR.
21. B is correct.  

$$\frac{\text{CAD}}{\text{GBP}} = \left( \frac{\text{USD}}{\text{EUR}} \right) * \frac{\frac{\text{EUR}}{\text{GBP}}}{\frac{\text{USD}}{\text{CAD}}}$$
 Spot rate of  $\frac{\text{CAD}}{\text{GBP}} = 1.285 * \frac{1.174}{1.122} = 1.344$   
 Expected spot rate of  $\frac{\text{CAD}}{\text{GBP}} = 1.275 * \frac{1.168}{1.141} = 1.305$   
 The expected depreciation of the GBP relative to CAD =  $\frac{1.305}{1.344} - 1 = -2.90\%$
22. A is correct.  $\text{MXN/EUR} = \text{MXN/USD} * \text{USD/EUR} = 12.3 * 1.45 = 17.83$ .
23. B is correct.  

$$\frac{\text{USD}}{\text{GBP}} = \frac{\text{USD}}{\text{MXN}} * \frac{\text{MXN}}{\text{GBP}} = \frac{1}{2.0880} * 2.1097 = 1.0104$$
24. B is correct.  
 Step 1: Find the spot rate for the EUR/AUD

$$\text{Spot} = \text{Forward rate} - \text{Points} = 1.3300 - 300/10,000 = 1.3000.$$

Step 2: Calculate the cross rate

$$\frac{\text{USD}}{\text{AUD}} = \frac{\text{USD}}{\text{EUR}} * \frac{\text{EUR}}{\text{AUD}} = 0.7400 * 1.300 = 0.9620.$$

25. B is correct. The forward exchange rate is  $1.3047 + 26.8 / 10,000 = 1.3074$ .

26. C is correct. The forward exchange rate is  $1.3047 (1 + 0.01576) = 1.3253$ .

27. C is correct.

Forward basis points

$$\begin{aligned} &= (\text{Forward Rate} - \text{Spot Rate}) \\ &* 10,000 \text{ (For a currency with 4 decimal point convention)} \\ &= (1.1527 - 1.1468) * 10,000 = 59 \end{aligned}$$

28. B is correct.

$$\text{Forward rate} = \text{Spot rate} * (1 + \text{forward premium})$$

$$1.1430 = \text{Spot rate} * (1 + 0.072)$$

$$\text{Spot rate} = 1.066$$

29. A is correct. Forward rate = Spot rate  $* \frac{1 + i_{\text{price currency}}}{1 + i_{\text{base currency}}}$

$$= 81.31 * \frac{1 + 0.0014}{1 + 0.0484} = 77.66$$

30. C is correct. Forward rate = Spot rate  $* \frac{1 + i_{\text{price currency}}}{1 + i_{\text{base currency}}}$

$$= 81.31 * \frac{1 + 0.0014 * \frac{90}{360}}{1 + 0.0484 * \frac{90}{360}}$$

$$= 81.31 * \frac{1.00035}{1.0121} = 80.37.$$

31. B is correct. . Forward rate = Spot rate  $* \frac{1 + i_{\text{price currency}}}{1 + i_{\text{base currency}}}$

$$= 0.7378 * \frac{1 + 0.01214 * \frac{270}{360}}{1 + 0.0126 * \frac{270}{360}}$$

$$= 0.7378 * \frac{1.009105}{1.00945} = 0.7375.$$

32. A is correct. The base currency will trade at a forward premium if the interest rate in the price currency is higher than the interest rate in the base currency.

33. B is correct. The base currency will trade at a forward discount if the interest rate in the base currency is higher than the interest rate in the price currency.

34. C is correct. The base currency is said to be trading at a forward premium if it is the currency with the lower interest rate.

35. A is correct. Covered interest arbitrage will ensure identical terminal values by investing the same initial amounts at the respective country's domestic interest rates:

$$\text{GBP investment: } £2.1986 * \left(1 + 0.015051 * \frac{180}{360}\right) = £2.2151$$

$$\text{NZD investment: } \text{NZ\$}1 * \left(1 + 0.038085 * \frac{180}{360}\right) = \text{NZ\$}1.0190$$

The forward rate is determined by equating these two terminal amounts:

$$\text{GBP/NZD forward Rate} = \frac{£2.2151}{\text{NZ\$}1.0190} = £2.1738/\text{NZ\$}$$

$$\text{Forward points} = (\text{Forward} - \text{Spot}) * 10,000 = (2.1738 - 2.1986) * 10,000 = -248.0.$$

36. B is correct. In this question we are told that the investor shorts INR which means that he sells INR and gets THB:  $500,000 / 2.1026 = \text{THB } 237,800.82$

$$\text{This money is invested at 3.5\%: } \text{THB } 237,800.82 * 1.035 = \text{THB } 246,123.85$$

Since the investor sold INR in the spot market he will buy INR in the forward market to take advantage of the arbitrage opportunity:  $246,123.85 * 2.1287 = 523,923.84$

$$\text{Arbitrage profit} = \text{INR } 523,923.84 - \text{INR } 523,000 = 924 \text{ (approx.)}.$$

37. A is correct. Forward rate = Spot rate  $* \frac{1 + i_{\text{price currency}}}{1 + i_{\text{base currency}}}$ .

$$10.4479 = 10.2562 * \frac{1.09}{1 + x} = 1.07. \text{ This implies a risk-less interest rate of 7\% in IND.}$$

38. A is correct.

$$F_{\text{JPY/GBP}} = 66.45 \left( \frac{1 + 0.0042 \left( \frac{90}{360} \right)}{1 + 0.0588 \left( \frac{90}{360} \right)} \right) = 65.56$$

39. A is correct.

$$\begin{aligned} \text{Forward basis points} &= (\text{Forward Rate} - \text{Spot Rate}) * 100 \text{ (For a 2 decimal place convention)} \\ &= (65.56 - 66.45) * 100 = -89 \end{aligned}$$

40. C is correct. In a CBS, the monetary authority has an obligation to maintain 100% foreign currency reserves against the monetary base. It thus cannot lend to troubled financial institutions.

41. B is correct. From an exchange rate risk perspective a floating exchange rate is most risky followed by a currency board. In dollarization there is no exchange rate risk.

42. A is correct. In a floating exchange rate regime the central bank is able to adjust monetary policy to maintain price stability. A currency board or dollarization exchange rate regime does not allow the central bank to exercise independent monetary policy to buffer its economy from inflation or deflation of the target currency.

43. C is correct. A is incorrect because it is the currency board system (not dollarization) where the monetary authority can earn a profit by paying little or no interest on its liability while paying a market rate on its assets. B is incorrect because a target zone regime has a fixed parity with horizontal intervention bands.

44. A is correct. If the Marshall-Lerner condition is satisfied, a depreciation of the domestic currency will reduce an existing trade deficit.

$$\omega_X \varepsilon_X + \omega_M (\varepsilon_M - 1) > 0.$$

$$\left(\frac{250}{550}\right) * 0.7 + \left(\frac{300}{550}\right) * -0.1 = 0.318 - 0.054 = 0.264 > 0.$$

45. B is correct. If the Marshall-Lerner condition is not satisfied, a depreciation of the domestic currency will increase an existing trade deficit.

$$\omega_X \varepsilon_X + \omega_M (\varepsilon_M - 1) > 0.$$

$$\left(\frac{250}{550}\right) * 0.2 + \left(\frac{300}{550}\right) * -0.7 = 0.091 - 0.382 = -0.291 < 0.$$

46. A is correct. The J-curve effect refers to the fact that depreciation of the domestic currency may increase a trade deficit in the short run even though it will eventually reduce the trade deficit.