

Reading 20: Currency Exchange Rates

Question #1 of 43

Question ID: 413952

An exchange rate at which two parties agree to trade a specific amount of one currency for another a year from today is called a:

- ☐ A) real exchange rate.
- ☐ B) spot exchange rate.
- ☒ C) forward exchange rate.

Explanation

A forward exchange rate specifies the amount of two currencies that will be exchanged at a specific point of time in the future. A transaction that uses the spot exchange rate is one that would occur immediately. A real exchange rate is one that has been adjusted for the relative inflation rates in two countries, and could be referring to an exchange rate that prevails at any given time.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #2 of 43

Question ID: 413958

The exchange rate for Chinese yuan (CNY) per euro (EUR) changed from CNY/EUR 8.1588 to CNY/EUR 8.3378 over a 3-month period. It is *most accurate* to state that the:

- ☐ A) CNY has depreciated 2.19% relative to the EUR.
- ☒ B) EUR has appreciated 2.19% relative to the CNY.
- ☐ C) EUR has appreciated 2.15% relative to the CNY

Explanation

The percentage change in the CNY value of one EUR is $(8.3378 / 8.1588) - 1 = 0.0219$. The EUR has appreciated 2.19% relative to the CNY. This is not the same as CNY depreciating by 2.19% relative to the EUR. The percentage change in the CNY is $[(1 / 8.3378) / (1 / 8.1588)] - 1 = -0.0215 = -2.15\%$.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #3 of 43

Question ID: 434260

Assuming no changes in the prices of a representative consumption basket in two currency areas over the measurement period, changes in the nominal exchange rate:

- X **A)** can be extrapolated to calculate interest rates.
- ✓ **B)** are equal to changes in the real exchange rate.
- X **C)** can be converted to the real exchange rate using interest rates.

Explanation

The real interest rate = the nominal interest rate × ratio of consumption basket (or index) price levels in both countries. Assuming no price changes, the real exchange rate has remained the same as the nominal interest rate during the period.

You can think of the ratio of the consumption basket (or index) price levels in two countries as the bracketed portion of the Fisher relation for two countries. Here is the Fisher relation for two countries:

$$\frac{(1 + R_{\text{nominal A}})}{(1 + R_{\text{nominal B}})} = \frac{(1 + R_{\text{real A}})[1 + E(\text{inflation}_A)]}{(1 + R_{\text{real B}})[1 + E(\text{inflation}_B)]}$$

Here is the ratio of the consumption basket (or index) price levels in two countries:

$$\frac{[1 + E(\text{inflation}_A)]}{[1 + E(\text{inflation}_B)]}$$

If inflation in A is 10% and inflation in B is 0%, the ratio of consumption basket (or index) price levels is 1.1. If inflation in both countries is 0%, the ratio of consumption basket (or index) price levels is 1 and the nominal interest rate = the real interest rate. If the nominal interest rate = the real interest rate, changes in the nominal exchange rate = changes in the real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #4 of 43

Question ID: 413980

The USD/EUR spot exchange rate is 1.3500 and 6-month forward points are -75. The 6-month forward exchange rate is:

- X **A)** 1.3425, and the USD is at a forward discount.
- X **B)** 1.3575, and the USD is at a forward discount.
- ✓ **C)** 1.3425, and the USD is at a forward premium.

Explanation

For an exchange rate quoted to four decimal places, each forward point represents 0.0001. The 6-month forward exchange rate is 1.3500 – 0.0075 = 1.3425 USD/EUR. The USD is expected to appreciate against the EUR and is trading at a forward premium.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS

Question #5 of 43

Question ID: 413986

With respect to exchange rate regimes, crawling bands are *most likely* used in a transition toward:

- ☐ A) a fixed peg arrangement.
- ☐ B) a monetary union.
- ☒ C) floating exchange rates.

Explanation

When exchange rates are managed within crawling bands, the margin around a target exchange rate increases over time. This technique is sometimes used in a transition from fixed exchange rates to freely floating exchange rates.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS
-

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Question ID: 413948

Other things equal, a real exchange rate (stated as units of domestic currency per unit of foreign currency) will decrease as a result of an increase in the:

- ☐ A) nominal exchange rate (domestic/foreign).
- ☒ B) domestic price level.
- ☐ C) foreign price level.

Explanation

An increase in the domestic price level, other things equal, will decrease a real exchange rate. Increases in the nominal exchange rate or the foreign price level, other things equal, will increase a real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #7 of 43

Question ID: 413984

The spot exchange rate for United States dollars per United Kingdom pound (USD/GBP) is 1.5775. If 30-day interest rates are 1.5% in the United States and 2.5% in the United Kingdom, and interest rate parity holds, the 30-day forward USD/GBP exchange rate should be:

- ☐ A) 1.5788.
- ☐ B) 1.5621.
- ☒ C) 1.5762.

Explanation

Forward USD/GBP = spot USD/GBP \times (1 + U.S. interest rate) / (1 + UK interest rate)
= 1.5775 \times [(1 + 0.015/12) / (1 + 0.025/12)]
= 1.5762

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #8 of 43

Question ID: 413963

The exchange rate of the Athelstan riyal (ATH) with the British pound is 9.00 ATH/GBP. The exchange rate of the Mordred ducat (MOR) with the U.S. dollar is 2.00 MOR/USD. If the USD/GBP exchange rate is 1.50, the ATH/MOR cross rate is *closest to*:

- ☒ **A)** 3.00 ATH/MOR.
- ☐ **B)** 6.75 ATH/MOR.
- ☐ **C)** 12.00 ATH/MOR.

Explanation

The ATH/MOR cross rate = 9.00 ATH/GBP \times (1 / 1.50) GBP/USD \times (1 / 2.00) USD/MOR = 3.00 ATH/MOR.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #9 of 43

Question ID: 413982

Currency depreciation is *most likely* to affect the balance of trade when a country's imports are goods that:

- ☐ **A)** have relatively inelastic demand.
- ☒ **B)** have close substitutes.
- ☐ **C)** represent a small proportion of consumer spending.

Explanation

According to the elasticities approach, the more elastic the demand for imports or exports, the greater the effect on the balance of trade from currency depreciation. Demand is more elastic for imports or exports when they are primarily goods with close substitutes, luxury goods, or goods that represent a large proportion of a consumer's spending.

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #10 of 43

Question ID: 413979

Spot and one-month forward exchange rates are as follows:

	<u>Spot</u>	<u>1-month forward</u>
EUR/DEF	2.5675	2.5925
EUR/GHI	4.3250	4.2800
EUR/JKL	7.0625	7.0075

Based on these exchange rates, the EUR is *closest* to a 1-month forward:

- X **A)** premium of 1% to the DEF.
- ✓ **B)** premium of 1% to the GHI.
- X **C)** discount of 1% to the JKL.

Explanation

The EUR is at a forward premium to the GHI because the EUR/GHI forward rate is less than the EUR/GHI spot rate. The base currency, GHI, is at a forward discount of $\text{forward/spot} - 1 = 4.2800 / 4.3250 - 1 = -1.04\%$. The EUR is at a forward discount to the DEF and a forward premium to the JKL.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #11 of 43

Question ID: 413971

The spot exchange rate is 0.6243 USD/GBP and the 1-year forward rate is quoted as 3.016%. The 1-year forward exchange rate for USD/GBP is *closest to*:

- ✓ **A)** 0.6431.
- X **B)** 0.6544.
- X **C)** 0.6054.

Explanation

The one year forward rate is $0.6243 \times (1 + 0.03016) = 0.6431$.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #12 of 43

Question ID: 413949

If we compare the prices of goods in two countries through time, we can use the price information in concert with the quoted foreign exchange rate to calculate the:

- ✓ **A)** real exchange rate.
- X **B)** interest rate spread.
- X **C)** nominal exchange rate.

Explanation

A comparison of consumption costs between two markets can, in concert with the foreign exchange rate (also called the nominal exchange rate), be used to calculate the real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #13 of 43

Question ID: 413962

If the exchange rate value of the CAD goes from USD 0.60 to USD 0.80, then the CAD:

- X **A)** depreciated and Canadians will find U.S. goods cheaper.
- X **B)** depreciated and Canadians will find U.S. goods more expensive.
- ✓ **C)** appreciated and Canadians will find U.S. goods cheaper.

Explanation

The CAD is now more expensive in terms of USD, and thus it has *appreciated*. Therefore, each CAD yields more USD than before, and Canadians are able to purchase more U.S. goods with each CAD, making U.S. goods relatively cheaper.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #14 of 43

Question ID: 413987

A country's central bank announces a monetary policy goal of a stable exchange rate with the euro, which it defines as deviations of no more than 3% from its current exchange rate of 2.5000. The country's exchange rate regime is *best* described as a:

- ✓ **A)** target zone.
- X **B)** fixed peg.
- X **C)** crawling band.

Explanation

This exchange rate regime is best described as a target zone, or a system of pegged exchange rates within horizontal bands. A target zone allows wider exchange rate fluctuations than a conventional fixed peg arrangement, which typically limits the permitted range to within 1% of the pegged exchange rate. Management of exchange rates within crawling bands allows the percentage deviation from the pegged exchange rate to increase over time.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #15 of 43

Question ID: 413954

Participants in foreign exchange markets that can be characterized as "real money accounts" *most likely* include:

- ☐ A) hedge funds.
- ☐ B) central banks.
- ☒ C) insurance companies.

Explanation

Real money accounts are foreign exchange buy-side investors that do not use derivatives. Many mutual funds, pension funds, and insurance companies can be classified as real money accounts. Hedge funds typically use derivatives. Central banks usually do not act as investors in foreign exchange markets but may intervene in foreign exchange markets to achieve monetary policy objectives.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #16 of 43

Question ID: 413964

Given an exchange rate of USD/CAD 0.9250 and USD/CHF 1.6250, what is the cross rate for CAD/CHF?

- ☒ A) 1.7568.
- ☐ B) 0.5692.
- ☐ C) 1.5032.

Explanation

$(\text{USD/CHF } 1.6250) / (\text{USD/CAD } 0.9250) = \text{CAD/CHF } 1.7568$

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #17 of 43

Question ID: 413959

The exchange rate for Australian dollars per British pound (AUD/GBP) was 1.4800 five years ago and is 1.6300 today. The percent change in the Australian dollar relative to the British pound is *closest to*:

- ☐ A) appreciation of 10.1%.
- ☐ B) depreciation of 10.1%.
- ☒ C) depreciation of 9.2%.

Explanation

To correctly calculate the percentage change in AUD relative to GBP, convert the exchange rates so that AUD is the base currency: $1 / 1.4800 = 0.6757$ GBP/AUD five years ago and $1 / 1.6300 = 0.6135$ GBP/AUD today. The percentage change in the Australian dollar against the British pound is $0.6135 / 0.6757 - 1 = -9.2\%$.

Note that the GBP has appreciated against the AUD by $1.6300 / 1.4800 - 1 = 10.1\%$ over the same period.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #18 of 43

Question ID: 413965

Given the following quotes, GBP/USD 2.0000 and MXN/USD 8.0000, calculate the direct MXN/GBP spot cross exchange rate.

- ☒ A) 4.0000.
- ☐ B) 0.2500.
- ☐ C) 0.6250.

Explanation

Invert the first quote to read USD/GBP 0.5000. Then, $0.5000 \times 8.0000 = 4.0000$ MXN/GBP.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

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Question ID: 413989

The Marshall-Lerner condition suggests that a country's ability to narrow a trade deficit by devaluing its currency depends on:

- X **A)** capacity utilization in the domestic economy.
- ✓ **B)** elasticity of demand for imports and exports.
- X **C)** national saving relative to domestic investment.

Explanation

The Marshall-Lerner condition is an outcome of the elasticities approach to analyzing the balance of trade. It suggests that depreciation or devaluation of a currency is more likely to narrow a country's trade deficit if domestic demand for imports and foreign demand for the country's exports are more elastic. The absorption approach to analyzing the balance of trade implies that national saving must increase relative to domestic investment for a currency devaluation to narrow a trade deficit, which in turn depends on whether the economy is producing at maximum capacity (full employment or potential GDP) when the devaluation occurs.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #20 of 43

Question ID: 413968

If the spot exchange rate between the British pound and the U.S. dollar is GBP/USD 0.7775, and the spot exchange rate between the Canadian dollar and the British pound is CAD/GBP 1.8325, what is the USD/CAD spot cross exchange rate?

- ✓ **A)** 0.70186.
- X **B)** 0.42428.
- X **C)** 1.42477.

Explanation

First, convert GBP/USD 0.7775 to $1/0.7775 = \text{USD/GBP } 1.28617$.

Then, divide USD/GBP 1.28617 by CAD/GBP 1.8325 = USD/CAD 0.70187.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #21 of 43

Question ID: 434262

A currency exchange rate that is set today for an exchange to be made 90 days in the future is *best* described as a:

- ✓ **A)** forward exchange rate.
- X **B)** spot exchange rate.
- X **C)** real exchange rate.

Explanation

A forward exchange rate is a currency exchange rate for an exchange to be made in the future. Forward rates are quoted for various future dates (e.g., 30 days, 60 days, 90 days, or one year).

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #22 of 43

Question ID: 413966

An analyst observes that the exchange rate for Mexican pesos is MXN/USD 8.0000, and the exchange rate for Polish zlotys is PLN/USD 6.0000. The MXN/PLN exchange rate is closest to:

- X **A)** 0.7500.
- X **B)** 14.0000.
- ✓ **C)** 1.3333.

Explanation

The cross rate of MXN/PLN is $(\text{MXN/USD } 8) / (\text{PLN/USD } 6) = 1.3333 \text{ MXN/PLN}$.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #23 of 43

Question ID: 413960

The exchange rate for Japanese yen (JPY) per euro (EUR) changes from 98.00 to 103.00 JPY/EUR. How has the value of the EUR changed relative to the JPY in percentage terms?

- X **A)** Depreciated by 4.9%.
- ✓ **B)** Appreciated by 5.1%.
- X **C)** Appreciated by 4.9%.

Explanation

Because the exchange rates are quoted with the EUR as the base currency, the percentage change is simply $103.00 / 98.00 - 1 = 5.1\%$. The increase in the quoted JPY/EUR exchange rate means it now requires 5.1% more JPY to purchase one EUR. Thus, the EUR has appreciated by 5.1% against the JPY.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #24 of 43

Question ID: 413969

The Japanese yen is trading at JPY/USD 115.2200 and the Danish krone (DKK) is trading at JPY/DKK 16.4989. The USD/DKK exchange rate is:

- ✓ **A)** 0.1432.
- X **B)** 0.5260.
- X **C)** 6.9835.

Explanation

The cross rate between USD and DKK is calculated in the following manner:

$$(USD/JPY)(JPY/DKK) = (1 / 115.2200) \times 16.4989 = USD/DKK 0.1432 \text{ (the Yen cancels out)}$$

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #25 of 43

Question ID: 413957

Which of the following would least likely be a participant in the forward market?

- X **A)** Traders.
- X **B)** Arbitrageurs.
- ✓ **C)** Long-term investors.

Explanation

Forward contracts are for 30, 90, 180, and 360-day periods and would, therefore, be considered short-term investment choices. Other participants in the forward market are hedgers who use forward contracts to protect the home currency value of foreign currency denominated assets on their balance sheets over the life of the contracts involved.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #26 of 43

Question ID: 434265

Country G and Country H have currencies that trade freely and have markets for forward currency contracts. If Country G has an interest rate greater than that of Country H, the no-arbitrage forward G/H exchange rate is:

- X **A)** less than the G/H spot rate.
- ✓ **B)** greater than the G/H spot rate.
- X **C)** equal to the G/H spot rate.

Explanation

$\frac{\text{forward}}{\text{spot}} = \frac{(1 + \text{interest rate}_{\text{Country G}})}{(1 + \text{interest rate}_{\text{Country H}})}$. If the interest rate in Country G is greater than the interest rate in Country H, the numerator is greater than the denominator on the right side of the equation. The left side must have the same relationship, so the forward rate must be greater than the spot rate.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS

Question #27 of 43

Question ID: 498751

Under the absorption approach, which of the following is *least likely* required to move the balance of payments towards surplus?

- ✓ **A)** Sufficient elasticities of export and import demand.
- X **B)** Increased savings relative to domestic investment.
- X **C)** Decreased domestic expenditure relative to income.

Explanation

Under the *elasticities approach* the elasticities of demand for exports and imports are the key to moving a country's balance of payments towards surplus. The *absorption approach* considers capital flows as well as goods flows. Under this approach, domestic expenditure relative to income must decrease to move the balance of trade towards surplus. Decreasing domestic expenditure relative to income is equivalent to increasing domestic savings, and an increase in savings relative to the current level of domestic investment will also move the balance of payments towards surplus under the absorption approach.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS

Question #28 of 43

Question ID: 434264

If the current spot exchange rate for quotes of JPY/GBP is greater than the no-arbitrage 3-month forward exchange rate, the 3-month GBP interest rate is:

- ✓ **A)** greater than the 3-month JPY interest rate.
- X **B)** equal to the 3-month JPY interest rate.
- X **C)** less than the 3-month JPY interest rate.

Explanation

$\frac{\text{forward}_{\text{JPY/GBP}}}{\text{spot}_{\text{JPY/GBP}}} = \frac{(1 + \text{interest rate}_{\text{JPY}})}{(1 + \text{interest rate}_{\text{GBP}})}$. If the no-arbitrage forward JPY/GBP rate is less than the spot rate, the interest rate for JPY must be less than the interest rate for GBP.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #29 of 43

Question ID: 441026

The spot exchange rate for Canadian dollars (CAD) per Swiss franc (CHF) is 1.1350 CAD/CHF and the 12-month forward exchange rate is 1.1460 CAD/CHF. The forward quote is a:

- ☐ A) discount of 110 points and the CAD is at a forward discount to the CHF.
- ☒ B) premium of 110 points and the CAD is at a forward discount to the CHF.
- ☐ C) premium of 11 points and the CAD is at a forward premium to the CHF.

Explanation

Because the forward CAD/CHF exchange rate is higher than the spot rate, the quote is a forward premium. Forward points represent 0.0001 for an exchange rate quoted to four decimal places. Here, the forward discount is $1460 - 1350 = 110$ points. The base currency, the CHF, is at a forward premium to the CAD, therefore the CAD is at a forward discount to the CHF.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #30 of 43

Question ID: 413967

If the CAD is trading at USD/CAD 0.6403 and the GBP is trading CAD/GBP 2.5207, the USD/GBP exchange rate is:

- ☐ A) 3.9367.
- ☒ B) 1.6140.
- ☐ C) 0.6196.

Explanation

$\text{USD/CAD } 0.643 \times \text{CAD/GBP } 2.5207 = \text{USD/GBP } 1.6140$.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #31 of 43

Question ID: 413974

The spot CHF/EUR exchange rate is 1.2025. If the 90-day forward quotation is +0.25%, the 90-day forward rate is *closest to*:

- ✓ **A)** 1.2055.
- X **B)** 1.2050.
- X **C)** 1.2000.

Explanation

The 90-day forward CHF/EUR exchange rate is $1.2025 \times 1.0025 = 1.20551$. The EUR is at a forward premium to the CHF.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #32 of 43

Question ID: 413955

The sell side of the foreign exchange markets primarily consists of:

- X **A)** retail investors.
- ✓ **B)** multinational banks.
- X **C)** accounting firms.

Explanation

The sell side of foreign exchange markets is primarily large multinational banks. They are the primary dealers in currencies and originators of forward foreign exchange contracts.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #33 of 43

Question ID: 434267

The spot rate for Chinese yuan per Canadian dollar is 6.4440. If the Canadian interest rate is 2.50% and the Chinese interest rate is 3.00%, the 3-month no-arbitrage forward rate is *closest to*:

- X **A)** 6.475 CNY/CAD.
- X **B)** 6.436 CNY/CAD.

✓ **C)** 6.452 CNY/CAD.

Explanation

The calculation is as follows:

$$\begin{aligned} F_{\frac{\text{CNY}}{\text{CAD}}} &= S_{\frac{\text{CNY}}{\text{CAD}}} \times \frac{(1+i_{\text{China}})}{(1+i_{\text{Canada}})} \\ &= 6.444 \times \frac{(1+0.030/4)}{(1+0.025/4)} \\ &= 6.452 \end{aligned}$$

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #34 of 43

Question ID: 413975

If the no-arbitrage forward exchange rate for a euro in Japanese yen is less than the spot rate, then the interest rate in:

- ✓ **A)** Japan is less than in the eurozone.
- X **B)** Japan is the same as in the eurozone.
- X **C)** the eurozone is less than in Japan.

Explanation

If the quote is in terms of JPY per EUR, this implies that the JPY is expected to appreciate relative to the EUR. There will be no arbitrage opportunity only if the interest rate in Japan is lower than the interest rate in the eurozone.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #35 of 43

Question ID: 413972

The spot exchange rate is 1.1132 GBP/EUR and the 1-year forward rate is quoted as +1349 points. The 1-year forward exchange rate for GBP/EUR is *closest to*:

- X **A)** 1.2634.
- X **B)** 1.1267.
- ✓ **C)** 1.2481.

Explanation

The one year forward is $1.1132 + (1349/10,000) = 1.2481$.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #36 of 43

Question ID: 413988

The tendency for currency depreciation to increase a country's trade deficit in the short run is known as the:

- ✓ **A)** J-curve effect.
- X **B)** absorption effect.
- X **C)** Marshall-Lerner effect.

Explanation

The J-curve refers to a graph of the effect of currency depreciation on the trade balance over time. In the short run, a trade deficit may increase because current import and export contracts may be fixed in foreign currency units over the near term, and only reflect the exchange rate change over time. In the long run, currency depreciation should decrease a trade deficit.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #37 of 43

Question ID: 413973

If the AUD/CAD spot exchange rate is 0.9875 and 60-day forward points are -25, the 60-day AUD/CAD forward rate is *closest to*:

- X **A)** 0.9870.
- X **B)** 0.9900.
- ✓ **C)** 0.9850.

Explanation

For an exchange rate quoted to four decimal places, forward points are expressed in units of 0.0001. The 60-day forward rate is $0.9875 + 0.0001(-25) = 0.9850$.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #38 of 43

Question ID: 413985

In which of the following exchange rate regimes can a country participate without giving up its own currency?

- X **A)** Crawling peg or formal dollarization.
- ✓ **B)** Target zone or conventional fixed peg.
- X **C)** Monetary union or currency board.

Explanation

With formal dollarization or a monetary union, a country does not have its own currency. With a currency board, conventional fixed peg, target zone, or crawling peg, a country has its own currency and manages its exchange rate with another currency or basket of currencies.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS

Question #39 of 43

Question ID: 434266

The spot rate for Japanese yen per UK pound is 138.78. If the UK interest rate is 1.75% and the Japanese interest rate is 1.25%, the 6-month no-arbitrage forward rate is *closest to*:

- X **A)** 138.10 JPY/GBP.
- ✓ **B)** 138.44 JPY/GBP.
- X **C)** 138.95 JPY/GBP.

Explanation

The calculation is as follows:

$$\begin{aligned} F_{\text{JPY}}^{\text{GBP}} &= S_{\text{JPY}}^{\text{GBP}} \times \frac{(1 + i_{\text{Japan}})}{(1 + i_{\text{Great Britain}})} \\ &= 138.78 \times \frac{(1 + 0.0125 / 2)}{(1 + 0.0175 / 2)} \\ &= 138.44 \end{aligned}$$

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS

Question #40 of 43

Question ID: 413970

The spot exchange rate for CHF/EUR is 0.8342 and the 1-year forward quotation is -0.353%. The 1-year forward exchange rate for EUR/CHF is *closest to*:

- X **A)** 0.8313.
- ✓ **B)** 1.2029.
- X **C)** 1.2022.

Explanation

The forward rate for CHF/EUR is $0.8342 \times (1 - 0.00353) = 0.8313$. The 1-year forward EUR/CHF exchange rate is $1 / 0.8313 = 1.2030$.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #41 of 43

Question ID: 434263

In the foreign exchange markets, transactions by households and small institutions for tourism, cross-border investment, or speculative trading comprise the:

- ✓ **A)** retail market.
- X **B)** sovereign wealth market.
- X **C)** real money market.

Explanation

The retail foreign exchange market refers to transactions by households and relatively small institutions and may be for tourism, cross-border investment, or speculative trading.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #42 of 43

Question ID: 413951

In the currency market, traders quote the:

- X **A)** base currency rate.
- X **B)** real exchange rate.
- ✓ **C)** nominal exchange rate.

Explanation

The nominal exchange rate is quite simply the price of one currency relative to another. It is the quote observed in currency markets.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS
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Question #43 of 43

Question ID: 434261

The difference between Country D's nominal and real exchange rates with Country F is *most* closely related to:

- ✓ **A)** the ratio of the two countries' price levels.
- X **B)** the risk-free interest rates of the two countries.
- X **C)** Country D's inflation rate.

Explanation

The difference between real exchange rates and nominal exchange rates is the relative inflation rates over time between the two countries. Real exchange rate (D/F) = nominal exchange rate (D/F) $\times \frac{CPI_F}{CPI_D}$.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS