ECON 1010C
Principles of Macroeconomics
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Assignment 6

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Part A Multiple-Choice Questions

1. If a Canadian company buys steel from Russia, then the purchase will be recorded in the:
A) Canadian current account.
B) Canadian capital account.
C) Canadian financial account.
D) Russian capital account.

2. If a French billionaire buys stock in the bank of Montreal, then the purchase will be recorded in the:
A) Canadian current account.
B) French current account.
C) Canadian financial account.
D) Canadian services account.

3. If Kenya's government buys $1 million with its own currency, this will enter the Kenyan balance of payments as part of its:
A) current account.
B) capital account.
C) financial account.
D) services account.

4. A French firm buys $10 million worth of Canadian bonds. This transaction causes the Canadian:
A) current account balance to increase.
B) current account balance to decrease.
C) financial account balance to increase.
D) financial account balance to decrease.

5. Canada increased its official reserves (foreign currencies) in 2001. One can conclude all of the following except:
A) the financial account balance decreased as a result.
B) the financial account balance increased as a result.
C) the Bank of Canada sold Canadian dollars in order to increase its official reserves.
D) the net asset flow associated with the increased reserves was negative.

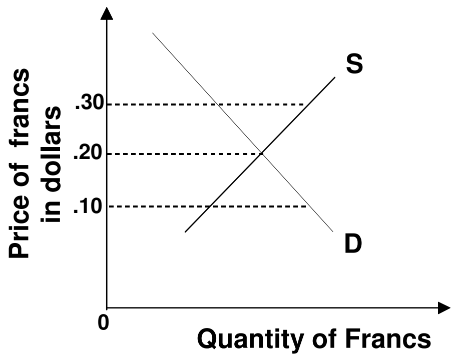
6. A country with a balance of payments deficit:
A) accumulates official reserves while its currency loses value.
B) decumulates official reserves while its currency loses value.
C) accumulates official reserves while its currency gains value.
D) decumulates official reserves while its currency gains value.

7. The calculation of Canada's balance of payments (surplus or deficit):
A) includes official reserve transactions as part of the net transfers account.
B) excludes official reserve transactions.
C) includes official reserve transactions as part of the current account.
D) includes official reserve transactions as part of the capital account.

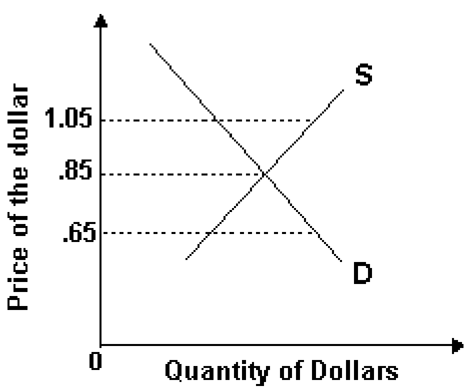
8. The supply of francs on the foreign exchange market slopes __________ because French consumers buy __________ foreign goods when the value of the franc decreases.
A) upward; fewer.
B) upward; more.
C) downward; fewer.
D) downward; more.

9. If foreign exchange traders expect the dollar to depreciate in the short run but the economic fundamentals suggest that it will appreciate:
A) the dollar is likely to depreciate in the short run.
B) the dollar is likely to appreciate in the short run.
C) no change in value of the dollar is likely.
D) the change in the value of the dollar cannot be predicted.

10. Which of the following is *not* a fundamental determinant of the exchange rate?
A) A country's income.
B) A country's price level.
C) A country's interest rates.
D) A country's unemployment rate.



11. Refer to the graph above. If the price of francs is $.30, the quantity of francs supplied is __________ than the quantity demanded. This causes the franc to __________ value.
A) greater; gain.
B) less; gain.
C) greater; lose.
D) less; lose.

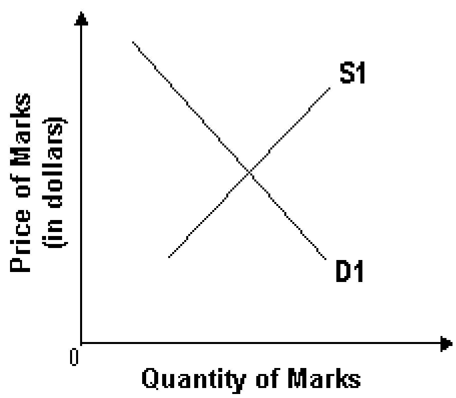


12. Refer to the graph above. If the price of the dollar is .65, then Canada has a balance of payments:
A) surplus that will cause the dollar to lose value.
B) surplus that will cause the dollar to gain value.
C) deficit that will cause the dollar to lose value.
D) deficit that will cause the dollar to gain value.

13. If both Canadian prices and Japanese income increase, then:
A) the dollar will lose value in terms of yen.
B) the dollar will gain value in terms of yen.
C) the dollar's value will not change in terms of yen.
D) the change in the dollar's value cannot be determined.

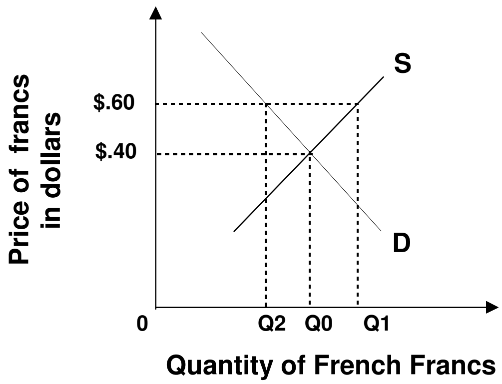
14. If Canadian interest rates rise relative to Japanese interest rates but Japanese inflation falls relative to Canadian inflation, then:
A) the dollar will lose value in terms of yen.
B) the dollar will gain value in terms of yen.
C) the dollar's value will not change in terms of yen.
D) the change in the dollar's value cannot be determined.

15. In 1999 the euro fell in value from about \$1.16 dollars per euro to about \$1.02 dollars per euro. This trend might be explained by:
A) lower economic growth in Europe.
B) lower interest rates in Europe.
C) lower inflation in Europe.
D) Central bank sales of Canadian dollars.



16. Refer to the graph above. An increase in American interest rates would:
A) shift D1 out and S1 in, causing an appreciation of the mark.
B) shift D1 out and S1 out, causing a depreciation of the mark.
C) shift D1 in and S1 in, causing an appreciation of the mark.
D) shift D1 in and S1 out, causing a depreciation of the mark.

17. If the price level in Canadian falls relative to the price level in foreign nations, Canadian exports ________ and Canadian imports ________, causing the demand for dollars to ________ and the supply of dollars to _______.
A) increase, decrease, rise, fall.
B) decrease, increase, fall, rise.
C) decrease, decrease, rise, rise.
D) increase, decrease, fall, rise.



18. Refer to the graph above. To maintain the price of francs at $.60 the government must buy:
A) Q1-Q0 francs.
B) Q1-Q2 francs.
C) Q0-Q2 francs.
D) Q2 francs.

19. Currency stabilization policy is:
A) always successful.
B) is successful only if the government can identify the long-run equilibrium value of the exchange rate.
C) is successful only if the government does not attempt to affect market expectations.
D) is never successful.

20. If a basket of goods costs $10 in Canada and 100,000 rubles in Russia, then purchasing power parity will exist if the exchange rate between the ruble and the dollar is:
A) 1,000 rubles per dollar.
B) 10,000 rubles per dollar.
C) 0.01 dollars per ruble.
D) 0.1 dollars per ruble.

21. Suppose a given basket of goods and services costs 9 dollars in Australia and 5400 baht in Thailand. If the exchange rate is 600 baht per Australian dollar, purchasing power parity implies that:
A) the exchange rate has attained its long run equilibrium value.
B) the Australian dollar must appreciate to restore purchasing power parity.
C) the Australian dollar must depreciate to restore purchasing power parity.
D) the baht must depreciate to restore purchasing power parity.

22. Flexible exchange rates:
A) give governments a greater degree of policy independence than fixed exchange rates.
B) make it simpler to engage in international trade than fixed exchange rates.
C) produce smaller exchange rate fluctuations than fixed exchange rates.
D) impose a greater degree of discipline on the behavior of central banks than fixed exchange rates.

23. Fixed exchange rates:
A) do not restrict exchange rate movements.
B) limit foreign exchange market intervention.
C) give governments greater flexibility in their use of monetary policy than flexible exchange rates.
D) are difficult to maintain without sufficient official reserves.

24. The best exchange rate system:
A) is a fixed exchange rate system.
B) is a flexible exchange rate system.
C) is a partially fixed exchange rate system.
D) has not yet been determined.

25. Partially flexible exchange rates:
A) provide governments with a more independent monetary policy than flexible exchange rates.
B) produce fewer exchange rate changes in general than fixed exchange rates.
C) mix market forces with government intervention in a way that allows exchange rates to respond to speculative pressures.
D) mix market forces with government intervention in a way that permits the exchange rate to respond to long-term balance of payments problems.

26. If the current interest rate in euro-area is 3% and Canadian dollar is expected to depreciate against Euro by 5% over next one year, then according the uncovered interest rate parity condition, the current interest rate in Canada should be:
A) 8%
B) 2%
C) -2%
D) 4%

Part B True/ False/ Uncertain Questions

Explain why the following statement is True, False, or Uncertain according to economic principles. Use diagrams and / or numerical examples where appropriate. Unsupported answers will receive no marks. It is the explanation that is important

B-1. According to fundamental analysis, a rise in U.S. GDP and a fall in Canadian interest rates relative to U.S. interest rates jointly would lead to an increase in price of U.S. dollars in terms of Canadian dollars.

Part C Problem Solving Questions

Answer all parts of the following question.

C-1

Chapter 16 Problems and Exercises - Number 1 and 5