IBS 601
Introduction to International Economics
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Assignment 5

Part A Multiple-Choice Questions

To answer each question correctly, you have to choose the best answer from the given four choices.

1. Which of the following activities generates an increase in a nation's demand for foreign currency?
   A) American tourists visit Japan
   B) a US firm imports goods from Europe
   C) An individual in the US buys bonds from France
   D) all of the above

Answer: D pg. 281 (page number of Salvatore's textbook)

2. If the US dollar price of the Japanese yen changes from $1 per 100 yen to $1.50 per 100 yen, the dollar is said to have _____________ and the yen has ______________.
   A) appreciated, depreciated
   B) depreciated, appreciated
   C) appreciated, appreciated
   D) depreciated, depreciated

Answer: B pg. 286

3. The exchange rate between any two currencies is kept the same in different monetary centers by ____________.
   A) the effective exchange rate
   B) speculation
   C) arbitrage
   D) hedging

Answer: C pg. 289

4. A transaction that calls for the payment and receipt of the foreign exchange within two business days from the transaction date is a:
   A) forward transaction
   B) spot transaction
   C) arbitrage transaction
   D) foreign discount with respect to the domestic currency

Answer: B pg. 292

5. A _______________ is a contract giving the purchaser the right, but not the obligation, to buy or to sell a standard amount of a traded currency on a stated date or at any time before a stated date and at a stated price.
   A) foreign exchange option
   B) futures transaction
   C) spot transaction
   D) forward transaction

Answer: A pg. 297

6. Assume there is an increase in the American demand for Japanese cameras. This results in:
   A) An increase in the demand for yen
   B) An decrease in the demand for yen
   C) An increase in the supply of yen to the US
   D) An decrease in the supply of yen to the US

Answer: A pg. 283

7. ________________ refers to the covering of an open position by eliminating some level of risk.
   A) Arbitrage
   B) Hedging
   C) Foreign exchange risk
   D) Speculation

Answer: B pg. 298

8. __________________ refers to the purchase of a foreign currency when the domestic price of the foreign currency falls or is low, in the expectation that it will soon rise, thus leading to a profit.
   A) Destabilizing speculation
   B) Stabilizing speculation
   C) Hedging
   D) Arbitrage

9. If you have a commitment to pay a friend in Britain 1,000 pounds in 30 days, and you are holding US dollars, you could remove the risk of loss due to the appreciation of the pound by:
   A) Buying dollars in the 30-day forward market
   B) Selling dollars in the 30-day forward market
   C) Buying pounds in the 30-day forward market
   D) Selling pounds in the 30-day forward market

Answer: C pg. 302

10. Suppose the exchange rate of the British pound is $1.75 per pound while the exchange value of the Swiss franc is $0.667 cents per franc. The cross exchange rate between the pound and the franc is:
   A) .381 franc per pound
   B) 1.167 francs per pound
   C) Cannot determine
   D) 2.624 francs per pound

Answer: D pg. 287

11. Which of the following states that the equilibrium exchange rate is equal to the ratio of price levels in the two nations?
A) The relative theory of exchange rate determination
B) The absolute purchasing-power parity theory
C) The relative purchasing-power parity theory
D) The absolute theory of exchange rate determination

Answer: B Page: 314

12. If the price for a Big Mac in the US is $2.00 and the price for a Big Mac in the UK is £3, what is the absolute purchasing-power parity equilibrium exchange rate between the dollar and the Euro (using the dollar as the domestic currency)?
A) .667
B) 1.5
C) .333
D) None of the above

Answer: A Page: 314

13. According to the relative purchasing-power parity theory, what is the percentage change in the exchange rate if the price for one unit of corn in the US is $10 in 2003 and $12 in 2004, and in the UK, £15 in 2003 and £20 in 2004?
A) -14.7%
B) 13.3%
C) -13.3%
D) 10.5%

Answer: C Page: 315

14. Which of the following approaches to exchange rate determination stresses the role of the flow of goods and services in the determination of exchange rates?
A) The portfolio model of exchange rates
B) The asset model of exchange rates
C) The trade approach to exchange rates
D) All of the above

Answer: C Page: 313

15. Which of the following approaches to exchange rate determination postulates that exchange rates are determined in the process of equilibrating or balancing the demand and supply of financial assets in each country?
A) The asset model of exchange rates
B) The trade approach to exchange rates
C) The elasticities approach to exchange rates
D) None of the above

Answer: A Page: 319

16. From which of the following does a nation's supply of foreign exchange arise?
A) From the inflow of foreign investment
B) From the sale of foreign currency by the speculators when the expect the foreign currency to depreciate
C) From the exportation of goods and services to other nations
D) All of the above

Answer: D		Page: 311

17. A nation's currency will depreciate if the nation's economy experiences which of the following?
A) An increase in the price level
B) Economic growth
C) Expectations of depreciation
D) All of the above

Answer: D		Page: 311

18. Which of the following would occur if the interest rate in the United States fell relative to that in the UK, and before this increase the dollar was in an exchange rate equilibrium with the sterling?
A) The United States will now demand fewer imports
B) The UK will now demand fewer pounds
C) The UK will supply more pounds to the US
D) None of the above

Answer: D		Page: 313

19. The elasticities approach is more useful in explaining exchange rates during which time frame?
A) Short run
B) Medium run
C) Long run
D) All of the above

Answer: C		Page: 314

20. An increase in the nation's money supply leads to which of the following?
A) Proportionate increases in prices
B) Proportionate decreases in prices
C) Depreciation of the nation's currency in the long run
D) Both a & c

Answer: D		Page: 319

21. Monetary and asset or portfolio models have not been very successful in forecasting exchange rates, especially in the short run, due to which of the following reasons?

A) Exchange rates are strongly affected by new information that is characteristically unpredictable
B) Although offering theoretical support for the conclusions drawn by the models, the models are weak econometrically speaking
C) Expectations of exchange market participants often become self-fulfilling
D) Both a & c

Answer: D

22. A depreciation of the US dollar makes US products ___________________ for European residents, because European residents need _______ euros to purchase each dollar.

A) cheaper, more
B) cheaper, fewer
C) more expensive, more
D) more expensive, fewer

Answer: B pg. 336

23. The price elasticity of the ______________ in euros is given by the percentage change in the quantity demanded of US exports by foreigners divided by the percentage change in the price of US exports in euros.

A) US demand for exports
B) Foreign demand for US imports
C) US demand for imports
D) Foreign demand for US exports

Answer: D pg. 337

24. If the US currency pass-through is 60 percent, what will occur as a result of a 15 percent depreciation in the value of the dollar?

A) import prices to fall by 9 percent
B) import prices to rise by 15 percent
C) export prices to fall by 9 percent
D) export prices to rise by 15 percent

Answer: B pg. 339

25. The US demand for euros is always___________.

A) negatively sloped
B) positively sloped

C) perfectly elastic
D) perfectly inelastic

Answer: A pg. 337

26. The US supply curve of euros can be either positively sloped, negatively sloped or vertical, depending on the elasticity of the ____________________
    A) US supply curve of euros, foreign demand for European imports in terms of euros
    B) US demand curve for euros, foreign demand for US exports in terms of euros
    C) US demand curve for euros, foreign demand for European imports in terms of euros
    D) US supply curve of euros, foreign demand for US exports in terms of euros

Answer: D pg. 337

27. When a(n) ___________________ condition is present, a disturbance from the equilibrium exchange rate gives rise to automatic forces that push the exchange rate back toward the equilibrium rate.
    A) unstable foreign exchange market
    B) Marshall-Lerner condition
    C) J-curve effect
    D) stable foreign exchange market

Answer: D pg. 338

28. The foreign exchange market is stable (able to correct a trade deficit by a depreciation of the nation's currency) if ____________________
    A) the sum of the absolute values of price elasticities of the US demand for imports and the foreign demand for US exports is greater than one.
    B) the sum of the absolute values of price elasticities of the US demand for imports and the foreign demand for US exports is less than one.
    C) the sum of the absolute values of price elasticities of the US supply of exports and the foreign supply of imports is greater than one.
    D) the sum of the absolute values of price elasticities of the US demand for imports and the foreign demand for US exports is greater than one.

Answer: A pg. 339

29. The ________________ explains why it may take up to two years for a currency depreciation to make significant reductions in a nation's trade deficit.
    A) J-curve effect
    B) Pass-through
    C) Marshall-Lerner condition
    D) Multiplier effect

Answer: A pg. 339

30. The ________________ operated from about 1880 until the outbreak of World War I in 1914.
    A) gold standard
    B) silver standard
    C) stable foreign exchange market
    D) Marshall-Lerner condition

Answer: A pg. 341

31. Suppose a £1 gold coin in the UK contained 115 grains of pure gold, while a $1 gold coin in the US contained 25 grains. What is the mint parity exchange rate between pounds and dollars?
    A) £4.87 per dollar
    B) $4.87 per pound
    C) $.22 per pound
    D) £0.22 per dollar

Answer: B pg. 341

32. Assume ₣1 (French franc) gold coin in France contains 445.824 grains of pure gold, while the $1 gold coin in the US contains 23.22 grains. If the cost of shipping ₣1 from Paris to New York was 4 cents, the gold export point of the French franc is _____, and the gold import point is ________.
    A) $103.56, $103.48
    B) $19.24, $19.16

C) $19.16, $19.24
D) Cannot be determined from information given

Answer: B pg. 343

33. _____________ represents the fixed exchange rates defined by the gold content of each nation's currency.
    A) Purchaing power parity
    B) Pass through
    C) Mint parity
    D) Price-specie-flow

34. The ________________ served as the automatic adjustment mechanism under the gold standard exchange system.
    A) mint parity
    B) gold import point
    C) price-specie-flow mechanism
    D) purchasing power parity model

Answer: C pg. 343

35. The equilibrium level of national income in the economy is where _______________.
    A) the ratio of leakages to savings = the ratio of injection to consumption
    B) leakages = injections
    C) leakages + injections = consumption + investment
    D) consumption – investment = zero

Answer: B pg. 346

36. The closed economy multiplier is equal to _____________.
    A) The reciprocal of the marginal propensity to save
    B) The reciprocal of the marginal propensity to consume
    C) The slope of the savings function
    D) The ratio of savings to investment

Answer: A pg. 346

37. If for every one dollar increase in income, savings increases by 25 cents, the marginal propensity to *consume* is _________ and the closed economy multiplier is ______.

A) .25, 4
B) .75, 4
C) .25, .04
D) .75, 1.333

Answer: B pg. 346

38. The increase in imports induced per dollar increase in income is called the________________.

A) import elasticity of demand
B) marginal propensity to import
C) income elasticity of imports
D) none of the above

Answer: B pg. 347

39. The equilibrium level of income in an open economy is where:

A) Savings + Investment = Imports + Exports
B) Consumption + Savings = Imports + Exports
C) Savings + Exports = Investment + Imports
D) Savings + imports = Investment + Exports

Answer: D pg. 347

40. The ratio of the change in income to the change in exports and/or investments is:

A) the multiplier
B) the foreign trade multiplier
C) equilibrium level of income
D) the marginal propensity to save

Answer: B pg. 348

41. Business cycles tend to impact nations other than the nation in which they are occurring because of ________________.

   A) foreign repercussions
   B) absorption
   C) the income elasticity of imports
   D) the foreign multiplier

Answer: A pg. 352

42. According to the J-curve effect, when a nation's currency appreciates, the nation's trade balance:

   A) Will first move toward deficit, then toward surplus
   B) Will first move toward surplus, then toward deficit
   C) Will move toward deficit and remain there
   D) Will move toward surplus and remain there

Answer: C pg. 339

43. Which of the following is one of the most important of a nation's economic goals or objectives?

A) Internal balance
B) A reasonable growth rate
C) An equitable distribution of income
D) All of the above

Answer: D Page: 365

44. Tariffs and quotas are used to restrict the flow of international trade and capital. These are examples of:

A) expenditure-changing policies
B) direct controls
C) expenditure-switching policies
D) indirect controls

Answer: B Page: 366

45. Which of the following is an indicator of a contractionary fiscal policy?

A) Reduced money supply
B) Reduced government expenditures
C) Reduction in taxes
D) None of the above

Answer: B Page: 365

46. Which of the following is an example of an expansionary monetary policy?
A) Increase in the nation's money supply
B) Increased government expenditures
C) Reduction in taxes
D) All of the above

47. Which of the following is a type of internal *and* external imbalance?
A) Inflation and recession
B) Recession and deficit
C) Deficit and surplus
D) All of the above

Answer: B Page: 367

48. To achieve internal balance under a fixed exchange rate system, what policies should be used?
A) Expenditure-changing policies
B) Devaluation policies
C) Revaluation polices
D) None of the above

Answer: A Page: 366

49. What is the correct order of events following an expansionary fiscal policy with a fixed exchange rate?
A) Interest rates rise, overall balance-of-payments may improve, money supply falls to defend fixed exchange rate
B) Production and income rise, money supply falls to defend fixed exchange rate, capital flows in
C) Interest rate rises, capital flows in, overall balance-of-payments may improve
D) Production and income rise, money supply falls to defend fixed exchange rate, overall balance-of-payments may improve

Answer: C Page: 370

50. What is the correct order of events following an expansionary monetary policy with a fixed exchange rate?
A) Interest rate falls, investment and income rise, current account worsens
B) Interest rate falls, current account worsens, money supply falls in order to maintain fixed exchange rate
C) Capital flows out, interest rate falls, overall balance-of-payments worsens
D) None of the above

Answer: A Page: 369

51. What actions should be taken under the internal-external imbalance of inflation and surplus with a fixed exchange rate?

A) Expansionary fiscal policy to correct for excess surplus, and expansionary monetary policy to correct for inflation
B) Expansionary fiscal policy to correct for inflation, and contractionary monetary policy to correct for surplus
C) Contractionary fiscal policy to correct for inflation, and expansionary monetary policy to correct for surplus
D) Contractionary fiscal policy to correct for excess surplus, and contractionary monetary policy to correct for inflation

Answer: C Page: 373

52. Under a flexible exchange rate system, which policies can be used to achieve internal balance?

A) Monetary policies alone
B) Fiscal policies alone
C) Neither monetary nor fiscal policies
D) Both monetary and fiscal policies

Answer: A Page: 373

53. What is the correct order of events following an expansionary monetary policy with a flexible exchange rate?

A) Interest rate falls, investment and income rise, current account worsens
B) Currency depreciates, income rises more, current account improves
C) Current account worsens, interest rate falls, investment and income rise
D) Capital flows out, interest rate falls, currency depreciates

Answer: A Page: 375

54. Which of the following is an example of an exchange control?

E) Restrictions on international capital flows
F) Intervention in forward markets
G) Multiple exchange rates
H) All of the above

Answer: D Page: 382