

**Multiple choice questions**  
**Economics 160 B**  
**Summer Session II, 2007**

**MULTIPLE CHOICE:** Choose the best answer. Write answer on the table below.

1	a	b	c	d
2	a	b	c	d
3	a	b	c	d
4	a	b	c	d
5	a	b	c	d

6	a	b	c	d
7	a	b	c	d
8	a	b	c	d
9	a	b	c	d
10	a	b	c	d

1. According to uncovered interest rate parity, if the 3-month nominal interest rate in South Africa is below that in the U.S., then the financial market expects the South African exchange rate (Rand per US dollar) over the next 3 months to
  - (a) fall.
  - (b) rise.
  - (c) not change.
  - (d) ambiguous due to real interest rate parity.
  
2. Given the information in problem 1 above, under relative purchasing power parity, which country is expected to have the higher inflation rate over the next 3 months?
  - (a) South Africa.
  - (b) U.S.
  - (c) neither, they are exactly the same.
  - (d) ambiguous due to real interest rate parity.
  
3. According to the monetary approach to exchange rates, if money growth is 5% higher in the US than in Japan, and output growth is 2% higher in the US than in Japan, then the value of the dollar relative to the yen should depreciate by
  - (a) 7%
  - (b) 5%
  - (c) 3%
  - (d) 2%
  
4. Absolute purchasing power parity holds best
  - (a) when prices are sticky.
  - (b) in the long run.
  - (c) when there is no risk premium.
  - (d) in the absence of capital controls.

5. According to the policy “Trilemma,” how can China have both fixed exchange rates and an independent monetary policy?
  - (a) it cannot.
  - (b) only if it holds enough foreign reserves.
  - (c) only if PPP fails.
  - (d) only if it restricts financial market openness with capital controls.
6. The “twin deficits” hypothesis says that:
  - (a) there can be a deficit both in the current account and the financial account.
  - (b) national saving must equal investment.
  - (c) a government budget deficit causes a financial account deficit.
  - (d) low government saving causes a low current account balance.
7. The exchange rate overshooting theory is useful because it offers an explanation for:
  - (a) twin deficits.
  - (b) risk premium.
  - (c) exchange rate volatility.
  - (d) sticky prices.
8. When you purchase shares in the Japanese stock market, this transaction involves a
  - (a) debit in the financial account.
  - (b) debit in the current account.
  - (c) credit in the financial account.
  - (d) credit in the financial account.
9. If Denmark commits itself in the foreign exchange market to fixing its exchange rate to the euro (in units of kroner/euro) at a level below the initial market equilibrium, then Denmark’s holdings of euro reserves will:
  - (a) fall
  - (b) rise
  - (c) not change
10. Risk sharing through international portfolio diversification reduces volatility in
  - (a) gross national product (GDP).
  - (b) gross national income (GNI).
  - (c) exchange rates.
  - (d) investment expenditure.