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

1 | a | b | c | d | 6 | a | b | c | d |
2 | a | b | c | d | 7 | a | b | c | d |
3 | a | b | c | d | 8 | a | b | c | d |
4 | a | b | c | d | 9 | a | b | c | d |
5 | 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.