

Homework #1: FT chapter 2

Econ 160B: International Macroeconomics

Due in class October 9

1. Refer to the exchange rates below to answer the following questions.

Table: Exchange Rate Quotations (June 9, 2005)

Source: *The Economist*

Country (currency measured in FX units)	Per \$, $E_{FX/\$}$ (6/9/05)	Per \$, $E_{FX/\$}$ (6/9/04)	Per £, $E_{FX/£}$ (6/9/05)	Per €, $E_{FX/€}$ (6/9/05)
Britain (£)	0.54	0.56	-	0.68
Canada (C\$)	1.19	1.30	2.19	1.49
Denmark (kroner)	5.95	6.17	10.97	7.45
Eurozone (€)	0.80	0.83	1.47	-
Hong Kong (HK\$)	7.76	7.80	14.32	9.73
Japan (¥)	109.13	110.5	201.21	136.76
United States (\$)	-	-	1.84	1.25

- a. Compute the U.S. dollar - HK\$ exchange rate $E_{\$/HK\$}$ on June 9 of 2004 and 2005.
 - b. Compute the U.S. dollar - British £ exchange rate $E_{\$/£}$ on June 9 of 2004 and 2005.
 - c. What happened to the value of the U.S. dollar relative to the HK\$ and British pound between June 9, 2004 and June 9, 2005? Compute the percentage change in the value of the U.S. dollar relative to each country using the exchange rates you computed in (a). Did the U.S. dollar appreciate or depreciated relative to the HK\$? The British pound?
 - d. Compute the Japanese yen-C\$ exchange rate $E_{¥/C\$}$ in June 2005.
2. Suppose you have \$5,000 you wish to invest. For each of the following scenarios explain whether you would be better off putting your money in the foreign or domestic alternative presented. (Assume that the level of risk is same for the two alternatives in each case.)
- a. You know you will need your money in 2 years. The annual interest rate on corporate bonds in the U.S. is 4% while corporate bonds in Peru carry an interest rate of 15%. The current exchange rate is 3.34 New Sol per dollar. You expect that in two years the exchange rate will be 4.8 New Sol per dollar.
 - b. You only want to invest for four months. The annual interest rate (for a whole year) on bank deposits on Euros is 4.5% while that on dollar deposits is 3.5%. The current exchange rate is 0.92 Euros per dollar. You expect the exchange rate to be 0.93 Euros per dollar four months from now.
3. a. Suppose that the South African interest rate is 4% and the U.S. interest rate is 6%. If the expected future spot exchange rate one year from now is 6.05 Rand per dollar and uncovered interest rate parity holds, what must the current spot exchange rate be in order to clear the foreign exchange market?
- b. Suppose that the expected future spot rate is 6.25 rather than 6.05. How does that alter the equilibrium exchange rate you calculated in part a?
- c. Using the expected exchange rate from part b, explain what would happen if the South African interest rate happened to be 6.7%. Can your answer to part b also be the answer to this question? Explain.
- d. Ignoring your expectations about the future spot rate, what would be the equilibrium forward exchange rate using the information given in part c if there is no risk premium and if covered interest rate parity holds?