***Financial Markets and Institutions, 7e* (Saunders)**

**Chapter 9 Foreign Exchange Markets**

1) If a foreign currency appreciates, that country's goods and services become relatively more expensive for U.S. buyers.

2) A U.S. firm agrees to import textiles from Hong Kong and pay in 90 days. The invoice requires payment in Hong Kong dollars. The U.S. importer could hedge this currency risk by buying the HK dollar forward.

3) In 1971, the Bretton Woods Agreement established that, for the first time, currency values would be fixed against one another within narrow bands.

4) In 1973, the Smithsonian Agreement II eliminated fixed exchange rates for the major economies.

5) If you can convert 150 Swiss francs to $90, the exchange rate is 1.67 francs per dollar.

6) If the dollar is initially worth 120 yen and then the exchange rate changes so that the dollar is now worth 115 yen, the value of the yen has depreciated.

7) If the euro per yen ratio falls, the value of the yen has risen.

8) If the United States has inflation of 3 percent and Europe has inflation of 5 percent, the value of the euro should increase, ceteris paribus.

9) A U.S. bank has made £12 million worth of loans and £10 million worth of deposits in Britain. The bank would benefit from a drop in the value of the pound against the dollar.

10) A country with lower interest rates than another country is likely to see its currency appreciate if parity holds.

11) During much of the 1800s, developed nations employed what came to be known as the Bretton Woods international monetary system to manage exchange rates.

12) New York is the global center of foreign exchange trading with the largest daily volume of currency trading.

13) A drop in value of the dollar hurts U.S. importers and helps U.S. exporters, ceteris paribus.

14) The dollar's value increased when the Fed cut interest rates in late 2007.

15) The ongoing accumulation of foreign currency reserves by foreign monetary authorities contributed to the dollar's drop in 2006.

16) Foreign exchange trading in 2016 averaged about \_\_\_\_\_\_\_\_ per day.

A) $101 million

B) $5.09 trillion

C) $101 billion

D) $1.88 trillion

E) $101 trillion

17) In 2015, the U.S. imported goods and services worth about \_\_\_\_\_\_\_\_ and exported about \_\_\_\_\_\_\_\_ leading to a current account \_\_\_\_\_\_\_\_.

A) $3.7 trillion; $3.3 trillion; deficit

B) $3.2 trillion; $3.4 trillion; surplus

C) $3.4 trillion; $3.2 trillion; surplus

D) $3.2 trillion; $3.4 trillion; deficit

E) $3.0 trillion; $3.0 trillion; balance

18) A U.S. investor has borrowed pounds, converted them to dollars, and invested the dollars in the United States to take advantage of interest rate differentials. To cover the currency risk, the investor should

A) sell pounds forward.

B) buy dollars forward.

C) buy pounds forward.

D) sell pounds spot.

E) None of these choices are correct.

19) A U.S. bank borrowed dollars, converted them to euros, and invested in euro-denominated CDs to take advantage of interest rate differentials. To cover the currency risk the investor should

A) sell dollars forward.

B) sell euros forward.

C) buy euros forward.

D) sell euros spot.

E) None of these choices are correct.

20) A U.S. firm has £50 million in assets in Britain that they need to repatriate in six months. They could hedge the exchange rate risk by

A) buying pounds forward.

B) selling pounds forward.

C) borrowing pounds.

D) both selling pounds forward and borrowing pounds.

E) both buying pounds forward and borrowing pounds.

21) A U.S. firm has borrowed £50 million from a British firm. The borrower will need to convert dollars to pounds to repay the loan when it is due. The U.S. firm could hedge the exchange rate risk by

A) buying pounds forward.

B) selling pounds forward.

C) borrowing pounds.

D) both selling pounds forward and borrowing pounds.

E) both buying pounds forward and borrowing pounds.

22) A U.S. bank converted $1 million to Swiss francs to make a Swiss franc loan to a valued corporate customer when the exchange rate was 1.2 francs per dollar. The borrower agreed to repay the principal plus 5 percent interest in one year. The borrower repaid Swiss francs at loan maturity and when the loan was repaid the exchange rate was 1.3 francs per dollar. What was the bank's dollar rate of return?

A) 26.00 percent

B) −2.69 percent

C) 7.14 percent

D) −3.08 percent

E) 5.00 percent

23) A Swiss bank converted 1 million Swiss francs to euros to make a euro loan to a customer when the exchange rate was 1.85 francs per euro. The borrower agreed to repay the principal plus 3.75 percent interest in one year. The borrower repaid euros at loan maturity and when the loan was repaid the exchange rate was 1.98 francs per euro. What was the bank's franc rate of return?

A) 7.75 percent

B) 11.04 percent

C) 9.94 percent

D) −2.82 percent

E) 5.71 percent

24) A Japanese investor can earn a 1 percent annual interest rate in Japan or about 3.5 percent per year in the United States. If the spot exchange rate is 101 yen to the dollar, at what one-year forward rate would an investor be indifferent between the U.S. and Japanese investments?

A) ¥100.58

B) ¥98.56

C) ¥101.68

D) ¥97.42

E) ¥103.50

25) A European investor can earn a 4.75 percent annual interest rate in Europe or 2.75 percent per year in the United States. If the spot exchange rate is $1.58 per euro, at what one-year forward rate would an investor be indifferent between the U.S. and Japanese investments?

A) $1.5484

B) $1.6108

C) $1.5335

D) $1.5498

E) $1.5977

26) An investor starts with $1 million and converts it to 0.75 million pounds, which is then invested for one year. In a year the investor has 0.7795 million pounds, which she then converts to dollars at an exchange rate of 0.72 pounds per dollar. The U.S. dollar annual rate of return earned was \_\_\_\_\_\_\_\_.

A) 4.97 percent

B) 5.27 percent

C) 6.45 percent

D) 7.69 percent

E) 8.26 percent

27) An investor starts with €1 million and converts it to £694,500, which is then invested for one year. In a year the investor has £736,170, which she then converts back to euros at an exchange rate of 0.68 pounds per euro. The annual euro rate of return earned was \_\_\_\_\_\_\_\_.

A) 7.55 percent

B) 6.00 percent

C) 7.45 percent

D) 8.13 percent

E) 8.26 percent

28) Banks' net foreign exposure is equal to

A) net foreign assets.

B) net FX bought.

C) net foreign assets + net FX bought.

D) assets − liabilities.

E) None of these choices are correct.

29) If a firm has more foreign currency assets than liabilities, and no other foreign currency transactions, it has

A) positive net exposure.

B) negative net exposure.

C) a fully balanced position.

D) zero net exposure.

30) The levels of foreign currency assets and liabilities at banks have \_\_\_\_\_\_\_\_ in recent years, and the level of foreign currency trading has \_\_\_\_\_\_\_\_.

A) increased; increased

B) decreased; decreased

C) increased; decreased

D) decreased; increased

E) decreased; stayed the same

31) The agreement that ended the era of fixed exchange rates for the major economies was called the

A) Louvre Accord.

B) Bretton Woods Agreement.

C) Smithsonian Agreement I.

D) Smithsonian Agreement II.

E) Plaza Accord.

32) If interest rate parity holds and the annual German nominal interest rate is 3 percent and the U.S. annual nominal rate is 5 percent and real interest rates are 2 percent in both countries, then inflation in Germany is about \_\_\_\_\_\_\_\_ than in the United States.

A) 1 percent higher

B) 2 percent higher

C) 1 percent lower

D) 4 percent lower

E) 2 percent lower

33) At the beginning of the year the exchange rate between the Brazilian real and the U.S. dollar was 2.2 reals per dollar. Over the year, Brazilian inflation was 12 percent and U.S. inflation was 4 percent. If purchasing power parity holds, at year-end the exchange rate should be *approximately* \_\_\_\_\_\_\_\_ dollars per real.

A) 2.3913

B) 0.4895

C) 2.8498

D) 0.4182

E) 0.3440

34) The spot rate for the Argentine peso is $0.3600 per peso. Over the year, inflation in Argentina is 10 percent and U.S. inflation is 4 percent. If purchasing power parity holds, at year-end the exchange rate should be *approximately* \_\_\_\_\_\_\_\_ dollars per real.

A) 0.2987

B) 0.3614

C) 0.2875

D) 0.3384

E) 0.3015

35) The largest center for trading in foreign exchange is

A) New York.

B) London.

C) Tokyo.

D) Hong Kong.

E) Geneva.

36) A negotiated OTC agreement to exchange currencies at a fixed date in the future but at an exchange rate specified today is a

A) currency swap agreement.

B) forward foreign exchange transaction.

C) currency futures contract.

D) currency options contract.

E) spot foreign exchange transaction.

37) Which of the following conditions may lead to a decline in the value of a country's currency?

I. Low interest rates

II. High inflation

III. Large current account deficit

A) I only

B) I and II only

C) II and III only

D) II only

E) III only

38) The large U.S. current account deficit implies that

A) U.S. interest rates are too high.

B) the value of the dollar is too weak.

C) dollar foreign currency reserves at Asian central banks are too low.

D) the presidential administration desires to improve growth of overseas economies.

E) the United States must rely on foreigners to be willing to invest in the United States.

39) A current account deficit implies that

A) more goods and services are exported than are imported.

B) more goods and services are imported than are exported.

C) there is excessive consumption of foreign financial assets.

D) the value of the dollar will rise.

E) the country is going bankrupt.

40) Which of the following are likely to lead to an appreciation of the U.S. dollar (ceteris paribus)?

I. Higher real U.S. interest rates

II. Lower U.S. inflation

III. Higher nominal U.S. interest rates

A) II and III only

B) I and III only

C) I and II only

D) II only

E) I, II, and III

41) You can buy or sell the £ spot at $1.98 to the pound. You can buy or sell the pound one-year forward at $2.01 to the pound. If U.S. annual interest rates are 5 percent, what must be the approximate one-year British interest rate if interest rate parity holds?

A) 4.00 percent

B) 5.25 percent

C) 2.75 percent

D) 3.45 percent

E) 5.65 percent

42) You can buy or sell the yen spot at ¥102 to the dollar. You can buy or sell the yen one-year forward at ¥104 to the dollar. If U.S. annual interest rates are 4 percent, what must be the approximate one-year Japanese interest rate if interest rate parity holds?

A) 6.04 percent

B) 3.20 percent

C) 2.75 percent

D) 4.73 percent

E) 6.80 percent

43) A U.S. bank has £120 million in loans to corporate customers and has £70 million in deposits it owes to customers with the same maturity. The bank has also sold £20 million pounds forward. The bank's net exposure is

A) £210 million.

B) £30 million.

C) £70 million.

D) £170 million.

E) £190 million.

44) The \_\_\_\_\_\_\_\_ measures the net flows of imports and exports of goods, services, income payments, and unilateral transfers.

A) current account

B) capital account

C) change in official reserves

D) statistical discrepancy

E) basic balance account

45) The concept underlying purchasing power parity is the

A) Fisher effect.

B) Bretton Woods Agreement.

C) law of one price.

D) Big Mac Index.

E) balance of payments concept.

46) The value of the British pound changed from $1.40 to $1.15. We can say that the pound has \_\_\_\_\_\_\_\_ and the dollar has \_\_\_\_\_\_\_\_.

A) depreciated; appreciated

B) appreciated; appreciated

C) appreciated; depreciated

D) depreciated; depreciated

E) None of these choices are correct.

47) The value of the British pound changed from $1.23 to $1.32. We can say that the pound has \_\_\_\_\_\_\_\_ and the dollar has \_\_\_\_\_\_\_\_.

A) depreciated; appreciated

B) appreciated; appreciated

C) appreciated; depreciated

D) depreciated; depreciated

E) None of these choices are correct.

48) The value of the Euro changed from $1.15 to $1.25. We can say that the dollar has \_\_\_\_\_\_\_\_ and the euro has \_\_\_\_\_\_\_\_.

A) depreciated; appreciated

B) appreciated; appreciated

C) appreciated; depreciated

D) depreciated; depreciated

E) None of these choices are correct.

49) The value of the Euro changed from $1.20 to $1.14. We can say that the dollar has \_\_\_\_\_\_\_\_ and the euro has \_\_\_\_\_\_\_\_.

A) depreciated; appreciated

B) appreciated; appreciated

C) appreciated; depreciated

D) depreciated; depreciated

E) None of these choices are correct.

50) If the dollar appreciates relative to the Euro then:

A) European cars will become less expensive in the United States.

B) American cars will become less expensive in Europe.

C) the price of cars will not be affected.

D) European cars will become more expensive in the United States.

E) American cars will become less expensive in the United States.

51) What are the major purposes of the foreign exchange markets?

52) A U.S. FI has US$200 million worth of one-year loans earning an average rate of return of 6 percent. The FI also has one-year single-payment Canadian dollar loans of C$110 million earning 8 percent. The FI's funding source is $300 million in US$ one-year CDs, on which they are paying 4 percent. Initially the exchange rate is C$1.10 per US$1. The one-year forward rate is C$1.14 per US$1. What is the bank's dollar percent spread if they hedge fully using forwards?

53) A British bank has borrowed dollars in the United States, but is now concerned about its currency risk. What alternatives does it have to limit its risk? Be specific.

54) A bank has committed to deliver yen in six months to a corporate customer. The spot rate is 110 yen to the dollar and the six-month forward rate is 105 yen per dollar. Are there costs to hedging this exposure with the forward market? Explain.

55) An FI's position in FX markets generally reflects four trading activities. What are they, and which one(s) cause the FI to bear FX risk?

56) Is it reasonable to expect real rates of interest to be identical across countries? Explain. What does this imply about parity?

57) What are the major differences between the interbank foreign exchange market and the foreign currency exchanges?

58) Why does the size of the U.S. current account deficit put pressure on the value of the dollar to decline? How does the size of the capital account affect that pressure? Explain.

59) A U.S. bank has made £50 million loans in Britain and has £40 million in deposits. The bank's currency trading desk has also contracted to buy £20 million and has short positions of £15 million. What is the bank's net exposure? How could they use forward contracts to hedge the exposure? If the bank has exposures in euros and yen, would you recommend they use the forward hedge? Why or why not?

60) Explain how a drop in the value of the dollar could affect the U.S. import and export sectors.