

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 1) An important thing to remember about foreign exchange rate determination is that parity conditions, asset approach, and balance of payments approaches are \_\_\_\_\_ theories rather than \_\_\_\_\_ theories. 1) \_\_\_\_\_  
A) competing; complementary B) complementary; competing  
C) competing; contemporary D) complementary; contiguous
- 2) Which of the following did NOT contribute to the exchange rate collapse in emerging markets in the 1990s? 2) \_\_\_\_\_  
A) the sharp reduction of cross-border foreign direct investment  
B) speculation on the part of market participants  
C) infrastructure weaknesses  
D) All of the above contributed to the emerging markets exchange rate collapse of the 1990s.
- 3) The \_\_\_\_\_ provides a means to account for international cash flows in a standardized and systematic manner. 3) \_\_\_\_\_  
A) International Fisher Effect B) parity conditions  
C) balance of payments D) asset approach
- 4) The \_\_\_\_\_ approach argues that equilibrium exchange rates are achieved when the net inflow of foreign exchange arising from current account activities is equal to the net outflow of foreign exchange arising from financial account activities. 4) \_\_\_\_\_  
A) asset market B) monetary  
C) balance of payments D) law of one price
- 5) The \_\_\_\_\_ approach states that the exchange rate is determined by the supply and demand for national currency stocks, as well as the expected future levels and rates of growth of monetary stock. 5) \_\_\_\_\_  
A) law of one price B) balance of payments  
C) monetary D) asset market
- 6) The \_\_\_\_\_ approach argues that exchange rates are determined by the supply and demand for a wide variety of financial assets 6) \_\_\_\_\_  
A) balance of payments B) asset market  
C) law of one price D) monetary
- 7) The \_\_\_\_\_ approach to the determination of spot exchange rates hypothesizes that the most important factors are the relative real interest rate and a country's outlook for economic growth and profitability. 7) \_\_\_\_\_  
A) parity conditions B) managed float  
C) balance of payments D) asset market

- 8) The asset market approach to forecasting assumes that whether foreigners are willing to hold claims in monetary form depends on an extensive set of investment considerations. These include all but which of the following choices? 8) \_\_\_\_\_
- A) political safety
  - B) capital market liquidity
  - C) relative real interest rates
  - D) All of the above are considered by investors in their decision process.
- 9) \_\_\_\_\_ is defined as the spread of a crisis in one country to its neighboring countries and other countries with similar characteristics. 9) \_\_\_\_\_
- A) Political science
  - B) Speculation
  - C) Contagion
  - D) Capital market liquidity
- 10) Critics of the balance of payments approach to exchange rate determination point to the emphasis on \_\_\_\_\_ of currency and capital rather than \_\_\_\_\_ of money or financial assets. 10) \_\_\_\_\_
- A) export; import
  - B) stocks; flows
  - C) flows; stocks
  - D) import; export
- 11) Which of the following versions of PPP is thought to be the most relevant to possibly explaining what drives exchange rate values? 11) \_\_\_\_\_
- A) The International Fisher Effect
  - B) Relative Purchasing Power Parity
  - C) The Law of One Price
  - D) Absolute Purchasing Power Parity

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 12) It is safe to say that most determinants of the spot exchange rate are also affected by changes in the spot rate. i.e., they are linked AND mutually determined. 12) \_\_\_\_\_
- 13) The balance of payments approach of exchange rate theory is largely dismissed by the academic community today, while the practitioner public still rely on different variations of the theory for their decision making. 13) \_\_\_\_\_
- 14) Technical analysis of exchange rates developed in part due to the forecasting inadequacies of fundamental exchange rate theories. 14) \_\_\_\_\_
- 15) The authors claim that theoretical and empirical studies appear to show that fundamentals do apply to the long-term for foreign exchange. 15) \_\_\_\_\_
- 16) The authors claim that random events, institutional frictions, and technical factors may cause currency values to deviate significantly from their long-term fundamental path. 16) \_\_\_\_\_
- 17) The asset market approach to forecasting is not applicable to emerging markets. 17) \_\_\_\_\_
- 18) Most theories of technical analysis differentiate fair value from market value. 18) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 19) Describe the asset market approach to exchange rate determination. How is this consistent with economic theory of (say, security) prices in general?

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 20) \_\_\_\_\_ is the active buying and selling of the domestic currency against foreign currencies. 20) \_\_\_\_\_  
A) Foreign Direct Investment B) Indirect Intervention  
C) Federal Funding D) Direct Intervention
- 21) Which of the following is NOT a technique used by governments or central banks to impact domestic currency valuation? 21) \_\_\_\_\_  
A) Direct Intervention  
B) Capital Controls  
C) Indirect Intervention  
D) All of the above are techniques used to control currency valuation.
- 22) Which of the following is NOT a motivation for a government or central bank to manipulate domestic currency valuation? 22) \_\_\_\_\_  
A) spur too slow economic growth  
B) slow too rapid economic growth  
C) fight inflation  
D) All of the above are motivations for the government or central bank to manipulate currency values.

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- 23) Slow economic growth and continued unemployment problems are common reasons for central banks to hold currency values down. 23) \_\_\_\_\_
- 24) The fall in the value of the domestic currency will sharply reduce the purchasing power of foreign tourists in the country whose currency values are falling. 24) \_\_\_\_\_
- 25) The International Monetary Fund, as one of its basic principles (Article IV), encourages members to pursue "currency manipulation" to gain competitive advantages over other members as opposed to engaging in military action to achieve the same advantage. 25) \_\_\_\_\_
- 26) If a central bank wishes to "defend its currency," it might follow an *expansive* monetary policy, which would drive real rates of interest up. 26) \_\_\_\_\_
- 27) A country wishing for its currency to fall in value, particularly when confronted with a continual appreciation of its value against major trading partner currencies, the central bank may work to lower real interest rates, reducing the returns to capital. 27) \_\_\_\_\_

- 28) Indirect intervention for domestic currency valuation typically uses tools of monetary policy as opposed to using tools of fiscal policy. 28) \_\_\_\_\_
- 29) Direct intervention for currency valuation involves limiting the ability to exchange domestic currency for foreign currency. 29) \_\_\_\_\_

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.**

- 30) Explain how a central bank would engage in direct intervention to decrease the value of its domestic currency. Since the 1970s it has been difficult for central banks alone to engage in direct intervention to alter the value of their domestic currency. Identify and explain at least two other activities in which a central bank could engage to alter the value of their domestic currency. 30) \_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 31) Which of the following was NOT an international currency crisis in the 1990s and early 2000s? 31) \_\_\_\_\_  
 A) the Argentine Crisis  
 B) the Asian Crisis  
 C) the Canadian Crisis  
 D) All of the above were currency crises in the 1990s and 2000s.
- 32) The Asian Currency crisis appeared to begin in: 32) \_\_\_\_\_  
 A) South Korea.      B) Thailand.      C) Japan.      D) Taiwan.
- 33) The "tequila effect" is a slang term used to describe a form of financial panic called: 33) \_\_\_\_\_  
 A) contagion.      B) speculation.  
 C) contrary investing.      D) run on the market.
- 34) Prior to July 2, 1997, the Thai government: 34) \_\_\_\_\_  
 A) fixed the Bhat's value against the Korean won only.  
 B) fixed the Bhat's value against major currencies especially the U.S. dollar.  
 C) allowed the Thai Bhat to float against major currencies.  
 D) none of the above
- 35) The authors did NOT identify which of the following as a root of the Asian currency crisis? 35) \_\_\_\_\_  
 A) the rate of inflation in the United States      B) corporate socialism  
 C) banking stability and management      D) the collapse of some Asian currencies
- 36) The authors refer to the practice of many Asian firms being largely controlled by families of groups related to the governing body of the country as: 36) \_\_\_\_\_  
 A) cronyism.      B) insider trading.  
 C) not in my back yard.      D) illegal.

- 37) The principle focus of the IMF bailout efforts during the Asian financial crisis was: 37) \_\_\_\_\_  
 A) banking liquidity.  
 B) reestablishing fixed currency exchange rates in Asia.  
 C) dollarization of Asian currencies.  
 D) shareholder's wealth.
- 38) The \_\_\_\_\_ is the Argentine currency unit. 38) \_\_\_\_\_  
 A) peseta                      B) dollar                      C) real                      D) peso
- 39) A currency board is: 39) \_\_\_\_\_  
 A) designed to eliminate the power of politicians to exercise judgment by relying on an automatic and unbendable rule.  
 B) a structure, rather than a mere commitment, to limiting the growth of the money supply in the economy.  
 C) a recipe for conservative and prudent financial management.  
 D) all of the above
- 40) Argentina's economic performance in the 1990s while their peso was pegged to the U.S. dollar can be characterized as \_\_\_\_\_ rates of inflation and \_\_\_\_\_ rates of unemployment. 40) \_\_\_\_\_  
 A) high; high                      B) high; low                      C) low; low                      D) low; high
- 41) Which of the following did NOT contribute to the Russian currency crisis of 1998? 41) \_\_\_\_\_  
 A) a surprisingly healthy government surplus that was neither funding internal investment nor external debt service  
 B) generally deteriorating economic conditions  
 C) an accelerated flight of capital  
 D) all of the above

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- 42) In 1991 the Argentine peso was fixed to the value of the U.S. dollar on a one-to-one basis. 42) \_\_\_\_\_
- 43) Leading up to the Russian currency collapse of 1998, Russia followed a currency policy of managed float that allowed their currency to slide daily at a 1.5% per month rate. 43) \_\_\_\_\_

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- 44) \_\_\_\_\_, traditionally referred to as chartists, focus on price and volume data to determine past trends that are expected to continue into the future. 44) \_\_\_\_\_  
 A) Trappist monks                      B) Technical analysts  
 C) Mappists                      D) Filibusters

- 45) Examples of a business motivation for long-run exchange rate forecasts include all but which of the following? 45) \_\_\_\_\_
- A) the desire to hedge a 90-day security
  - B) a portfolio manager considering investing in foreign securities
  - C) a major capital investment in a foreign country
  - D) All of the above are examples of a business motivation for long-run exchange rate forecast.
- 46) Short-term foreign exchange forecasts are often motivated by such activities as \_\_\_\_\_ whereas long-term forecasts are more likely motivated by \_\_\_\_\_. 46) \_\_\_\_\_
- A) long-term investment; long-term capital appreciation
  - B) long-term capital appreciation; desire to hedge a receivable
  - C) the desire for long-term investment; the desire to hedge a payable
  - D) the desire to hedge a payable; the desire for long-term investment
- 47) A major U.S. multinational firm has forecast the euro/dollar rate to be €1.10/\$ one year hence, and an exchange rate of \$1.40 for the British pound (£) in the same time period. What does this imply the company's expected rate for the euro per pound to be in one year? 47) \_\_\_\_\_
- A) €1.54/£                      B) €1.40/£                      C) £1.54/€                      D) £1.40/€

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 48) The longer the time horizon of the technical analyst the more accurate the prediction of foreign exchange rates is likely to be. 48) \_\_\_\_\_
- 49) The single most important element of technical analysis is that future exchange rates are based on the current exchange rate. 49) \_\_\_\_\_
- 50) The more efficient the foreign exchange market is, the more likely it is that exchange rate movements are random walks. 50) \_\_\_\_\_
- 51) Technical analysts, traditionally referred to as *chartists*, focus on *fundamental* data to determine past trends that are expected to continue into the future. 51) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 52) Foreign exchange forecasting can be either long-term, or short-term in duration. Compare and contrast the motivation for and the techniques a forecaster might use for each of the time periods.

## Answer Key

Testname: UNTITLED4

- 1) B
- 2) D
- 3) C
- 4) C
- 5) C
- 6) B
- 7) D
- 8) D
- 9) C
- 10) C
- 11) B
- 12) TRUE
- 13) TRUE
- 14) TRUE
- 15) TRUE
- 16) TRUE
- 17) FALSE
- 18) TRUE
- 19) The asset market approach to exchange rate determination looks at relative interest rates and prospects for economic growth and profitability. This is consistent with the pricing of equity securities in that the price of a share of stock should reflect expectations about the timing, magnitude, and risk of future cash flows. In other words, expectations about what is to come is more important to the price of an asset, including currency prices, than what has occurred in the past.
- 20) D
- 21) D
- 22) D
- 23) TRUE
- 24) FALSE
- 25) FALSE
- 26) FALSE
- 27) TRUE
- 28) TRUE
- 29) FALSE
- 30) To decrease the value of its domestic currency, a central bank could choose to sell its own currency, thus making more currency available and driving down its value. Because markets have become so large, it is difficult to effectively move market in this manner.  
  
Alternative strategies may be to enlist other central banks to make a coordinated effort to sell the the currency into the market, thus putting more currency into play and having a greater negative impact on its value. Indirect intervention to drive down real interest rates is a second alternative, and the reduction of capital controls may be able to render a currency less valuable as well.
- 31) C
- 32) B
- 33) A

## Answer Key

Testname: UNTITLED4

34) B

35) A

36) A

37) A

38) D

39) D

40) D

41) D

42) TRUE

43) TRUE

44) B

45) A

46) D

47) A

48) FALSE

49) TRUE

50) TRUE

51) FALSE

52) Short-run forecasts are usually more tactical in nature as a firm may desire to reduce exchange rate risk associated with foreign receivable or payables. Technical factors and short-term market expectations are often more important for short-run forecasters than long-run parity or fundamental economic conditions. Long-run forecasts are more strategic in nature as firms make key decisions about entering new foreign markets. Longer time horizons tend to be less accurate but also require less accuracy. What forecasters typically desire is a general long-run understanding of the relationships between markets. Fundamental analysis and parity conditions tend to be more important than technical factors in this type of forecasting.