

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to follow these directions will cost you 1 point on the assignment and failure to type it will cost you 10 points.

1) (5 points each) Answer both parts with a brief explanation.

A) If the current exchange rate is ¥100/\$ and tomorrow it becomes ¥105/\$, then which currency is appreciating and which is depreciating?

B) If the current exchange rate is \$1.1/€ and tomorrow it becomes € 1.1/\$, then which currency is appreciating and which is depreciating?

2) (25 points each) Illustrate the following events on the supply and demand for  $\hat{P}$  measured in terms of US\$. Explain why the curve(s) moved as drawn.

A) The interest rates in England increase.

B) The price level in the USA increases.

3) (5 points) If the exchange rate is ¥100/\$ and € 1.10/\$, then what is the exchange rate between the yen and the euro? Explain your logic.

4) (5 points) If the forward rate for one quarter from now is \$1.2/€ and the spot rate is \$1.0/€ , then what is the forward premium or discount? Briefly explain your logic.

5) (15 points) Pretend you are a foreign student (I know it is a stretch.), and you have money in your currency for next semester's tuition. Would you purchase futures or options now to reduce your exchange rate risk? Explain your logic.

6) (15 points) Suppose the interest rate in the USA is 5% and in Germany is 6%. The forward rate is \$1.1/€ and the spot rate is \$1.2/€ . Would you expect money to flow into Germany, into the USA, or neither direction? Explain your logic and show all work.