

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 300 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 16-point question should take 8 minutes. You can save some extra minutes, but not many.

1) (8 points each) Use the table to the right to answer **THREE** of the following parts. Show all work and give a one sentence explanation for each calculation.

- What is the balance on goods and services?
- What is the current account balance?
- Why is an “increase in US-owned assets abroad” a negative number?
- If I had not given you the value for “Statistical discrepancy,” how could you determine its value?

2) (10 points each) For **TWO** of the following events, write the double entry bookkeeping entries and briefly explain how you chose those entries.

- I take a tour of Italy costing \$4,000.
- I send clothing to Iraq worth \$500.
- I buy shares of Nestlé for \$2,000. (Nestlé is from Switzerland.)

3) (10 points) Do **EITHER** Part A **OR** Part B.

- If the exchange rates are \$2/£ and ¥220/£, then what is the exchange rate between the \$ and the ¥? Explain your logic. What is the name of the principle you used?
- What is the difference between purchasing foreign exchange on the forward market and buying options on foreign exchange?

4) Do **ALL** three parts.

- (8 points) Suppose that Americans can make two bicycles per hour and six suitcases per hour. The Nigerians can make four bicycles per hour and six suitcases per hour. Which country has a comparative advantage in bicycles and which country has a comparative advantage in suitcases? Explain your logic.
- (30 points) Assuming that both countries have 20 hours of labor, draw both countries’ PPF and CPF. Draw the American curves on one diagram and the Nigerian curves on the other diagram. Explain why you drew the curves as you did.
- (8 points) Why is it that both countries gain from trade?

5) (16 points) Do **EITHER** Part A **OR** Part B.

- Using the graphs you drew in Question 4B, draw the world-wide supply of bicycles. Explain how you got the graph.
- Why should the world be concerned about protectionism?

6) (16 points) Do **EITHER** Part A **OR** Part B.

- Write the equation for *Interest Rate Parity*, also known as., *Covered Interest Arbitrage Parity*. Explain why the equation takes that form.
- As of Feb. 7, 2004, the three-month money market accounts in the USA pay an interest rate of 1.02% per year or 0.255% per quarter. The same accounts in the British pound pay 4.13% per year or 1.0325% per quarter. The spot rate was \$0.55/£. I cannot find out the forward rate. Suppose the three-month forward rate is \$0.53/£. Would you want to buy a British or an American account? Explain your logic and show all calculations you make.

7) (18 points) Illustrate on the supply and demand for the Hungarian Forint (HUF) measured in US\$, **EITHER** the event in Part A **OR** the event in Part B. Explain why the curve(s) moved as drawn.

- Hungarian bonds have their rating in Moody’s increase. (Moody’s says Hungary is less likely to default on their bonds.)
- The GDP of the USA improves.

Export of goods, services, and income	1500
Goods	1000
Services	300
Income from US assets abroad	200
Import of goods, services, and income	-1400
Goods	-900
Services	-400
Income payments on foreign assets in US	-100
Unilateral Transfers, net	-50
US-owned assets abroad, net (increase (-))	-750
Foreign-owned assets in US, net (increase (+))	880
Statistical discrepancy	-180