Wilfrid W. Csaplar Jr. Open Economy Macroeconomics Review Sheet for Exam 1

This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have inadvertently overlooked something. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones on the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them.

There is no review session for this test. I will be available in my office from 7:00 until 8:30 on Monday 2/9 if you have questions. We will have to arrange a time for the exam.

Chapter 1: What are trade, balance of payments, foreign exchange, and protectionism? Why do we care about protectionism, disequilibrium in exchange rates, financial crises in emerging markets, high structural unemployment in Europe, economic stagnation in Japan, job downsizing in the USA, transitional economies, and poverty in some countries? In the appendix, what determines which countries trade the most with which other countries?

Chapter 2: What are absolute and comparative advantage? How do we determine them? Which determines trading patterns? Be able to find the PPF and CPF for the straight-line, constant opportunity cost, situations and show that both countries can gain from trade. Be able to find the supply and demand for the two goods.

Chapter 13: Know what debits and credits are. Be able to do the double entry bookkeeping for exports of goods, imports of goods, exports of services, imports of services, sales of assets abroad, purchases of foreign assets, and unilateral transfers. If I gave you a table like 13.1, be able to calculate the items in the memoranda. Know why the current and capital accounts should add to zero. What is the international investment position? Why does it matter?

Chapter 14: What are the spot and forward foreign exchange markets? How can we tell if a currency is appreciating, depreciating, revaluing, or devaluing? Be able to move the supply and demand for foreign exchange. Understand how two and three-point arbitrage work. What is meant by a forward discount or premium? How is it calculated? Why would you use a currency swap? When would you use a future or an option? What is meant by hedging and how is it achieved? When is speculation stabilizing and when is it destabilizing? What are uncovered and covered interest arbitrage? How can you tell if there is covered interest arbitrage parity using the covered interest arbitrage margin? What is the eurocurrency market? Note that it is not the currency called the Euro. Ignore the appendix.

Non-graded assignment #2A to be covered with assignment #2.

1) (15 points) Suppose the spot exchange rate is 0.01 ¡ /¥ and the forward rate is 103¥/ ¡ . Which currency is selling for a forward premium? How can you tell? Is the Euro expected to appreciate, depreciate, revalue, or devalue in the future? Explain your logic.

2) (15 points) American University in Cairo (AUC) pays 1/4 of the salaries of American professors in US$ every month. If you were AUC's business office and wanted to hedge on the exchange rate, how would you do that? Explain your logic.

3) (15 points) Most of the points to the upper-left-hand side of the covered interest arbitrage parity (CIAP) line are points in which there is capital flow. Is it an outflow or an inflow? Explain your logic. Why is the no capital flows in the other area above the CIAP line?

4) (20 points each) Illustrate the following events on the supply and demand for the Egyptian Pound (LE) measured in terms of the US$. Explain why the curve(s) moved as drawn.
A) The Egyptian GDP increases.
B) The interest rates in the USA increases.

5) (15 points) Do you think most currency speculation is stabilizing or destabilizing? Explain your logic.