

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 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I will give extra time but I won't give a lot.

1) (12 points) For EITHER the quality of the customs union in Part A OR the customs union in Part B, determine whether that means there it is more likely to have greater trade creation or greater trade diversion. Explain your logic.

- A) The countries are geographically far apart.
- B) There is little pre-union trade between the countries.

2) (12 points each) For TWO of the following events, do the double entry bookkeeping. Briefly explain how you got each entry. What happens to net exports, current account, short-term financial account, and long-term financial account?

- A) A Canadian student pays tuition to Bethany College. Pretend he pays \$7000.
- B) You sold \$5000 worth of BP stock so you can pay your tuition.
- C) You sent \$100 worth of clothing to Ukrainian refugees in Poland.

3) (12 points) Answer EITHER Part A OR Part B.

- A) Suppose the exchange rate in London was 2€/£. In Paris, it is \$1/€. In New York, \$1.9/£. Explain how you can make money using three-point arbitrage.
- B) Suppose that you are going to be paid £1000 in three months. Explain how you could use an option to reduce exchange rate risk. Be specific like, "I would buy a __ option which is..." and explain what would happen if the pound appreciates over time and if it depreciates over time.

4) (12 points) Answer EITHER Part A OR part B.

- A) State the Marshall-Lerner condition. Explain why it makes sense.
- B) Draw the J-Curve and explain why it takes its shape.

5) (14 points) Draw the S/D for the Japanese yen, ¥, with the British pound, £, as the other currency. Illustrate EITHER the event in Part A OR the event in Part B. Explain why the curve(s) moved as drawn. Which currency appreciated? How can you tell?

- A) Japanese inflation increases.
- B) The Japanese GDP increases.

6) (16 points) Answer EITHER Part A OR Part B.

- A) Part of one of the equations we gave was $M = f(i, i^*, EA^*, P)$ For each variable, state whether an increase in that variable will cause M to increase or decrease. Explain why they will have those effects.
- B) Part of one of the equations we gave was $F = f(EA^*, RP^*, Y, W)$ For each variable, state whether an increase in that variable will cause M to increase or decrease. Explain why they will have those effects.

7) (16 points) Answer EITHER Part A OR Part B.

- A) We drew four graphs which showed how the money supply, interest rates, price level, and the exchange rate changed over time after a one-time increase in the money supply. Draw the diagram for the exchange rate. Explain why it changes in the direction it changes and why it does not eventually end

up back at the same exchange rate as it started.

B) What is the equation for relative PPP? Explain why it makes sense.

8) (20 points) Answer EITHER Part A OR Part B.

A) Draw the UK supply and demand for a product they import from China. The UK is in the process of negotiating a trade deal with India. Suppose they form a customs union. Draw the effects of that on the graph. Explain why the graph changed as drawn. Find the trade creation and the trade diversion. Briefly explain how you found each.

B) Explain the differences between a free trade area (FTA) and a customs union (CU). What are the advantages of turning a FTA into a CU? Explain your logic. Explain the differences between a CU and a common market (CM). What are the advantages of turning a CU into a CM? Explain your logic.

9) (24 points) Answer EITHER Part A OR Part B. Make sure you indicate which part you are doing and you will want to put actual numbers on the axes of both graphs.

A) Draw the supply and demand for the British **export** with goods priced in pounds, £, and the other country being the EU. Assume the exchange rate for what you just drew was 2€/£. Add another line which corresponds to an exchange rate of 1€/£. Explain why the line you moved and not the other line. Explain why it moved as drawn. Use your graph to find two points on either the supply of £ or the demand for £. Draw those two points on a new graph. Show the work which gave you the two points. Are those two points on the supply of £ or demand for £? Explain your logic.

B) Draw the supply and demand for the British **import** with goods priced in pounds, £, and the other country being the EU. Assume the exchange rate for what you just drew was 2€/£. Add another line which corresponds to an exchange rate of 1€/£. Explain why the line you moved and not the other line. Explain why it moved as drawn. Use your graph to find two points on either the supply of £ or the demand for £. Draw those two points on a new graph. Show the work which gave you the two points. Are those two points on the supply of £ or demand for £? Explain your logic.