Chapter 17
The Foreign Exchange Market

17.1 Foreign Exchange Market

1) The exchange rate is
   A) the price of one currency relative to gold.
   B) the value of a currency relative to inflation.
   C) the change in the value of money over time.
   D) the price of one currency relative to another.

   Answer: D
   Ques Status: Revised

2) Exchange rates are determined in
   A) the money market.
   B) the foreign exchange market.
   C) the stock market.
   D) the capital market.

   Answer: B
   Ques Status: Revised

3) Although foreign exchange market trades are said to involve the buying and selling of currencies, most trades involve the buying and selling of
   A) bank deposits denominated in different currencies.
   B) SDRs.
   C) gold.
   D) ECUs.

   Answer: A
   Ques Status: Previous Edition

4) The immediate (two-day) exchange of one currency for another is a
   A) forward transaction.
   B) spot transaction.
   C) money transaction.
   D) exchange transaction.

   Answer: B
   Ques Status: Revised
5) An agreement to exchange dollar bank deposits for euro bank deposits in one month is a
   A) spot transaction.
   B) future transaction.
   C) forward transaction.
   D) deposit transaction.
   Answer: C
   Ques Status: Revised

6) Today 1 euro can be purchased for $1.10. This is the
   A) spot exchange rate.
   B) forward exchange rate.
   C) fixed exchange rate.
   D) financial exchange rate.
   Answer: A
   Ques Status: Revised

7) In an agreement to exchange dollars for euros in three months at a price of $0.90 per euro, the price is the
   A) spot exchange rate.
   B) money exchange rate.
   C) forward exchange rate.
   D) fixed exchange rate.
   Answer: C
   Ques Status: Revised

8) When the value of the British pound changes from $1.25 to $1.50, the pound has _______ and the U.S. dollar has _______.
   A) appreciated; appreciated
   B) depreciated; appreciated
   C) appreciated; depreciated
   D) depreciated; depreciated
   Answer: C
   Ques Status: Revised
9) When the value of the British pound changes from $1.50 to $1.25, then the pound has _______ and the U.S. dollar has _______.
   A) appreciated; appreciated
   B) depreciated; appreciated
   C) appreciated; depreciated
   D) depreciated; depreciated
   Answer: B

Ques Status: Revised

10) When the value of the dollar changes from £0.5 to £0.75, then the British pound has _______ and the U.S. dollar has _______.
    A) appreciated; appreciated
    B) depreciated; appreciated
    C) appreciated; depreciated
    D) depreciated; depreciated
    Answer: B

Ques Status: Revised

11) When the value of the dollar changes from £0.75 to £0.5, then the British pound has _______ and the U.S. dollar has _______.
    A) appreciated; appreciated
    B) depreciated; appreciated
    C) appreciated; depreciated
    D) depreciated; depreciated
    Answer: C

Ques Status: Revised

12) When the exchange rate for the Mexican peso changes from 9 pesos to the U.S. dollar to 10 pesos to the U.S. dollar, then the Mexican peso has _______ and the U.S. dollar has _______.
    A) appreciated; appreciated
    B) depreciated; appreciated
    C) appreciated; depreciated
    D) depreciated; depreciated
    Answer: B

Ques Status: Revised
13) When the exchange rate for the Mexican peso changes from 10 pesos to the U.S dollar to 9 pesos to the U.S. dollar, then the Mexican peso has _______ and the U.S. dollar has _______.
   A) appreciated; appreciated
   B) depreciated; appreciated
   C) appreciated; depreciated
   D) depreciated; depreciated

   Answer: C
   Ques Status: Revised

14) On April 7, 2006, one U.S. dollar traded on the foreign exchange market for about 0.83 euros. Therefore, one euro would have purchased about _______ U.S. dollars.
   A) 0.83
   B) 1.00
   C) 1.20
   D) 1.83

   Answer: C
   Ques Status: Revised

15) On April 7, 2006, one U.S. dollar traded on the foreign exchange market for about 44.5 Indian rupees. Thus, one Indian rupee would have purchased about _______ U.S. dollars.
   A) 0.02
   B) 1.20
   C) 7.00
   D) 44.5

   Answer: A
   Ques Status: Revised

16) On April 7, 2006, one U.S. dollar traded on the foreign exchange market for about 1.30 Swiss francs. Therefore, one Swiss franc would have purchased about _______ U.S. dollars.
   A) 0.30
   B) 0.77
   C) 1.30
   D) 3.10

   Answer: B
   Ques Status: Revised
17) On April 7, 2006, one U.S. dollar traded on the foreign exchange market for about 2.86 Romanian new lei. Therefore, one Romanian new lei would have purchased about ________ U.S. dollars.
   A) 0.35
   B) 1.86
   C) 2.86
   D) 3.35

   Answer: A
   Ques Status: Revised

18) If the U.S. dollar appreciates from 1.25 Swiss franc per U.S. dollar to 1.5 francs per dollar, then the franc depreciates from ________ U.S. dollars per franc to ________ U.S. dollars per franc.
   A) 0.80; 0.67
   B) 0.67; 0.80
   C) 0.50; 0.33
   D) 0.33; 0.50

   Answer: A
   Ques Status: New

19) If the British pound appreciates from $0.50 per pound to $0.75 per pound, the U.S. dollar depreciates from ________ per dollar to ________ per dollar.
   A) £2; £2.5
   B) £2; £1.33
   C) £2; £1.5
   D) £2; £1.25

   Answer: B
   Ques Status: Revised

20) If the Japanese yen appreciates from $0.01 per yen to $0.02 per yen, the U.S. dollar depreciates from ________ per dollar to ________ per dollar.
   A) 100¥; 50¥
   B) 10¥; 5¥
   C) 5¥; 10¥
   D) 50¥; 100¥

   Answer: A
   Ques Status: Revised
21) If the dollar appreciates from 1.5 Brazilian reals per dollar to 2.0 reals per dollar, the real depreciates from ______ per real to ______ per real.
   A) $0.67; $0.50
   B) $0.33; $0.50
   C) $0.75; $0.50
   D) $0.50; $0.67
   E) $0.50; $0.75

   Answer: A

   Ques Status: Revised

22) When the exchange rate for the British pound changes from $1.80 per pound to $1.60 per pound, then, holding everything else constant, the pound has ______ and ______ expensive.
   A) appreciated; British cars sold in the United States become more
   B) appreciated; British cars sold in the United States become less
   C) depreciated; American wheat sold in Britain becomes more
   D) depreciated; American wheat sold in Britain becomes less

   Answer: C

   Ques Status: Revised

23) If the dollar depreciates relative to the Swiss franc
   A) Swiss chocolate will become cheaper in the United States.
   B) American computers will become more expensive in Switzerland.
   C) Swiss chocolate will become more expensive in the United States.
   D) Swiss computers will become cheaper in the United States.

   Answer: C

   Ques Status: Previous Edition

24) Everything else held constant, when a country’s currency appreciates, the country’s goods abroad become ______ expensive and foreign goods in that country become ______ expensive.
   A) more; less
   B) more; more
   C) less; less
   D) less; more

   Answer: A

   Ques Status: Revised
25) Everything else held constant, when a country’s currency depreciates, its goods abroad become ______ expensive while foreign goods in that country become ______ expensive.

A) more; less
B) more; more
C) less; less
D) less; more

Answer: D

Ques Status: Revised

17.2 Exchange Rates in the Long Run

1) According to the law of one price, if the price of Colombian coffee is 100 Colombian pesos per pound and the price of Brazilian coffee is 4 Brazilian reals per pound, then the exchange rate between the Colombian peso and the Brazilian reals is:

A) 40 pesos per real.
B) 100 pesos per real.
C) 25 pesos per real.
D) 0.4 pesos per real.

Answer: C

Ques Status: Revised

2) The starting point for understanding how exchange rates are determined is a simple idea called ______, which states: if two countries produce an identical good, the price of the good should be the same throughout the world no matter which country produces it.

A) Gresham’s law
B) the law of one price
C) purchasing power parity
D) arbitrage

Answer: B

Ques Status: Previous Edition

3) The ______ states that exchange rates between any two currencies will adjust to reflect changes in the price levels of the two countries.

A) theory of purchasing power parity
B) law of one price
C) theory of money neutrality
D) quantity theory of money

Answer: A

Ques Status: Previous Edition
4) The theory of PPP suggests that if one country’s price level rises relative to another’s, its currency should
   A) depreciate.
   B) appreciate.
   C) float.
   D) do none of the above.
   Answer: A
   Ques Status: Previous Edition

5) The theory of PPP suggests that if one country’s price level falls relative to another’s, its currency should
   A) depreciate.
   B) appreciate.
   C) float.
   D) do none of the above.
   Answer: B
   Ques Status: Previous Edition

6) The theory of PPP suggests that if one country’s price level rises relative to another’s, its currency should
   A) depreciate in the long run.
   B) appreciate in the long run.
   C) depreciate in the short run.
   D) appreciate in the short run.
   Answer: A
   Ques Status: Revised

7) The theory of PPP suggests that if one country’s price level falls relative to another’s, its currency should
   A) depreciate in the long run.
   B) appreciate in the long run.
   C) appreciate in the short run.
   D) depreciate in the short run.
   Answer: B
   Ques Status: Previous Edition
8) The theory of purchasing power parity cannot fully explain exchange rate movements because
   A) all goods are identical even if produced in different countries.
   B) monetary policy differs across countries.
   C) some goods are not traded between countries.
   D) fiscal policy differs across countries.

   Answer: C  
   *Ques Status: Previous Edition*

9) The theory of purchasing power parity states that exchange rates between any two currencies
   will adjust to reflect changes in
   A) the trade balances of the two countries.
   B) the current account balances of the two countries.
   C) fiscal policies of the two countries.
   D) the price levels of the two countries.

   Answer: D  
   *Ques Status: Previous Edition*

10) In the long run, a rise in a country’s price level (relative to the foreign price level) causes its
    currency to _______, while a fall in the country’s relative price level causes its currency to
    _______.

    A) appreciate; appreciate
    B) appreciate; depreciate
    C) depreciate; appreciate
    D) depreciate; depreciate

    Answer: C  
    *Ques Status: Previous Edition*

11) If the 2005 inflation rate in Canada is 4 percent, and the inflation rate in Mexico is 2 percent,
    then the theory of purchasing power parity predicts that, during 2005, the value of the
    Canadian dollar in terms of Mexican pesos will

    A) rise by 6 percent.
    B) rise by 2 percent.
    C) fall by 6 percent.
    D) fall by 2 percent.

    Answer: D  
    *Ques Status: Revised*
12) Assume that the following are the predicted inflation rates in these countries for the year: 2% for the United States, 3% for Canada; 4% for Mexico, and 5% for Brazil. According to the purchasing power parity and everything else held constant, which of the following would we expect to happen?

A) The Brazilian real will depreciate against the U.S. dollar.
B) The Mexican peso will depreciate against the Brazilian real.
C) The Canadian dollar will depreciate against the Mexican peso.
D) The U.S. dollar will depreciate against the Canadian dollar.

Answer: A
Ques Status: New

13) According to the purchasing power parity theory, a rise in the United States price level of 5 percent, and a rise in the Mexican price level of 6 percent cause

A) the dollar to appreciate 1 percent relative to the peso.
B) the dollar to depreciate 1 percent relative to the peso.
C) the dollar to depreciate 5 percent relative to the peso.
D) the dollar to appreciate 5 percent relative to the peso.

Answer: A
Ques Status: Revised

14) Higher tariffs and quotas cause a country’s currency to ________ in the ________ run, everything else held constant.

A) depreciate; short
B) appreciate; short
C) depreciate; long
D) appreciate; long

Answer: D
Ques Status: Revised

15) Lower tariffs and quotas cause a country’s currency to ________ in the ________ run, everything else held constant.

A) depreciate; short
B) appreciate; short
C) depreciate; long
D) appreciate; long

Answer: C
Ques Status: Revised
16) Anything that increases the demand for foreign goods relative to domestic goods tends to ______ the domestic currency because domestic goods will only continue to sell well if the value of the domestic currency is ______, everything else held constant.

A) depreciate; lower
B) depreciate; higher
C) appreciate; lower
D) appreciate; higher

Answer: A

Ques Status: Revised

17) Everything else held constant, increased demand for a country's ______ causes its currency to appreciate in the long run, while increased demand for ______ causes its currency to depreciate.

A) imports; imports
B) imports; exports
C) exports; imports
D) exports; exports

Answer: C

Ques Status: Revised

18) Everything else held constant, increased demand for a country’s exports causes its currency to ______ in the long run, while increased demand for imports causes its currency to ______

A) appreciate; appreciate
B) appreciate; depreciate
C) depreciate; appreciate
D) depreciate; depreciate

Answer: B

Ques Status: Revised

19) Everything else held constant, if a factor increases the demand for ______ goods relative to ______ goods, the domestic currency will appreciate.

A) foreign; domestic
B) foreign; foreign
C) domestic; domestic
D) domestic; foreign

Answer: D

Ques Status: Revised
20) Everything else held constant, if a factor decreases the demand for _______ goods relative to _______ goods, the domestic currency will depreciate.
   A) foreign; domestic
   B) foreign; foreign
   C) domestic; domestic
   D) domestic; foreign
   Answer: D
   Ques Status: Revised

21) An increase in productivity in a country will cause its currency to _______ because it can produce goods at a _______ price, everything else held constant.
   A) depreciate; lower
   B) appreciate; lower
   C) depreciate; higher
   D) appreciate; higher
   Answer: B
   Ques Status: Revised

22) If, in retaliation for "unfair" trade practices, Congress imposes a 30 percent tariff on Japanese DVD recorders, but at the same time, U.S. demand for Japanese goods increases, then, in the long run, ________, everything else held constant
   A) the Japanese yen should appreciate relative to the U.S. dollar
   B) the Japanese yen should depreciate relative to the U.S. dollar
   C) there is no effect on the Japanese yen relative to the U.S. dollar
   D) the Japanese yen could appreciate, depreciate or remain constant relative to the U.S. dollar
   Answer: D
   Ques Status: Revised

23) If the U.S. Congress imposes a quota on imports of Japanese cars due to claims of "unfair" trade practices, and Japanese demand for American exports increases at the same time, then, in the long run ________, everything else held constant.
   A) the Japanese yen will appreciate relative to the U.S. dollar
   B) the Japanese yen will depreciate relative to the U.S. dollar
   C) the Japanese yen will either appreciate, depreciate or remain constant against the U.S. dollar
   D) there will be no effect on the Japanese yen relative to the U.S. dollar
   Answer: B
   Ques Status: Revised
24) If the inflation rate in the United States is higher than that in Mexico and productivity is growing at a slower rate in the United States than in Mexico, then, in the long run, ________, everything else held constant.

A) the Mexican peso will appreciate relative to the U.S. dollar
B) the Mexican peso will depreciate relative to the U.S. dollar
C) the Mexican peso will either appreciate, depreciate, or remain constant relative to the U.S. dollar
D) there will be no effect on the Mexican peso relative to the U.S. dollar

Answer: A
Ques Status: Revised

25) If the Brazilian demand for American exports rises at the same time that U.S. productivity rises relative to Brazilian productivity, then, in the long run, ________, everything else held constant.

A) the Brazilian real will appreciate relative to the U.S. dollar
B) the Brazilian real will depreciate relative to the U.S. dollar
C) the Brazilian real will either appreciate, depreciate, or remain constant relative to the U.S. dollar
D) there is no effect on the Brazilian real relative to the U.S. dollar

Answer: B
Ques Status: Revised

26) Explain the law of one price and the theory of purchasing power parity. Why doesn't purchasing power parity explain all exchange rate movements? What factors determine long-run exchange rates?

Answer: With no trade barriers and low transport costs, the law of one price states that the price of traded goods should be the same in all countries. The purchasing power parity theory extends the law of one price to total economies. PPP states that exchange rates should adjust to reflect changes in the price levels between two countries. PPP may fail to fully explain exchange rates because goods are not identical, and price levels include traded and nontraded goods and services. Long-run exchange rates are determined by domestic price levels relative to foreign price levels, trade barriers, import and export demand, and productivity.

Ques Status: Revised
17.3 Exchange Rates in the Short Run

1) The theory of asset demand suggests that the most important factor affecting the demand for domestic and foreign assets is
   A) the level of trade and capital flows.
   B) the expected return on these assets relative to one another.
   C) the liquidity of these assets relative to one another.
   D) the riskiness of these assets relative to one another.

   Answer: B
   Ques Status: Revised

2) The _______ suggests that the most important factor affecting the demand for domestic and foreign assets is the expected return on domestic assets relative to foreign assets.

   A) theory of asset demand
   B) law of one price
   C) interest parity condition
   D) theory of foreign capital mobility

   Answer: A
   Ques Status: Revised

3) The theory of asset demand suggests that the most important factor affecting the demand for domestic and foreign assets is the _______ on these assets relative to one another.

   A) interest rate
   B) risk
   C) expected return
   D) liquidity

   Answer: C
   Ques Status: Revised

4) The condition that states that the domestic interest rate equals the foreign interest rate minus the expected appreciation of the domestic currency is called

   A) the purchasing power parity condition.
   B) the interest parity condition.
   C) money neutrality.
   D) the theory of foreign capital mobility.

   Answer: B
   Ques Status: Previous Edition
5) As the relative expected return on dollar assets increases, foreigners will want to hold more _______ assets and less _______ assets, everything else held constant.
   
   A) foreign; foreign  
   B) foreign; dollar  
   C) dollar; foreign  
   D) dollar; dollar  
   
   Answer: C  
   Ques Status: Revised

6) When Americans or foreigners expect the return on _______ assets to be high relative to the return on _______ assets, there is a higher demand for dollar assets and a correspondingly lower demand for foreign assets.
   
   A) dollar; dollar  
   B) dollar; foreign  
   C) foreign; dollar  
   D) foreign; foreign  
   
   Answer: B  
   Ques Status: Revised

7) When Americans or foreigners expect the return on _______ assets to be high relative to the return on _______ assets, there is a _______ demand for dollar assets, everything else held constant.
   
   A) dollar; foreign; constant  
   B) dollar; foreign; higher  
   C) foreign; dollar; higher  
   D) foreign; dollar; constant  
   
   Answer: B  
   Ques Status: Revised

8) When Americans or foreigners expect the return on dollar assets to be high relative to the return on foreign assets, there is a _______ demand for dollar assets and a correspondingly _______ demand for _______ foreign assets.
   
   A) higher; higher  
   B) higher; lower  
   C) lower; higher  
   D) lower; lower  
   
   Answer: B  
   Ques Status: Revised
9) If the interest rate is 7 percent on euro–denominated assets and 5 percent on dollar–denominated assets, and if the dollar is expected to appreciate at a 4 percent rate, for Francois the Frenchman the expected rate of return on dollar–denominated assets is

A) 11 percent.
B) 9 percent.
C) 5 percent.
D) 3 percent.
E) 1 percent.

Answer: B

Ques Status: Revised

10) If the interest rate is 7 percent on euro–denominated assets and 5 percent on dollar–denominated assets, and if the dollar is expected to appreciate at a 4 percent rate, the expected return on ______–denominated assets in ______ percent.

A) dollar; euros is 3
B) euro; dollars is 1
C) dollar; euros is 1
D) euro; dollars is 3

Answer: D

Ques Status: Revised

11) If the interest rate on euro–denominated assets is 13 percent and it is 15 percent on peso–denominated assets, and if the euro is expected to appreciate at a 4 percent rate, for Manuel the Mexican the expected rate of return on euro–denominated assets is

A) 11 percent.
B) 13 percent.
C) 17 percent.
D) 19 percent.

Answer: C

Ques Status: Revised

12) If the interest rate on euro–denominated assets is 13 percent and it is 15 percent on peso–denominated assets, and if the euro is expected to appreciate at a 4 percent rate, for Francois the Frenchman the expected rate of return on peso–denominated assets is

A) 11 percent.
B) 15 percent.
C) 17 percent.
D) 19 percent.

Answer: A

Ques Status: Revised
13) With a 10 percent interest rate on dollar deposits, and an expected appreciation of 7 percent over the coming year, the expected return on dollar deposits in terms of the foreign currency is
   A) 3 percent.
   B) 10 percent.
   C) 13.5 percent.
   D) 17 percent.
   Answer: D
   Ques Status: Revised

14) With a 10 percent interest rate on dollar deposits, and an expected appreciation of 7 percent over the coming year, the expected return on dollar deposits in terms of the dollar is
   A) 3 percent.
   B) 10 percent.
   C) 13.5 percent.
   D) 17 percent.
   Answer: B
   Ques Status: Revised

15) The expected return on dollar deposits in terms of foreign currency can be written as the sum of the interest rate on dollar deposits and the expected appreciation of the dollar.
   A) product
   B) ratio
   C) sum
   D) difference
   Answer: C
   Ques Status: Revised

16) In a world with few impediments to capital mobility, the domestic interest rate equals the sum of the foreign interest rate and the expected depreciation of the domestic currency, a situation known as the
   A) interest parity condition.
   B) purchasing power parity condition.
   C) exchange rate parity condition.
   D) foreign asset parity condition.
   Answer: A
   Ques Status: Previous Edition
17) According to the interest parity condition, if the domestic interest rate is 12 percent and the foreign interest rate is 10 percent, then the expected _______ of the foreign currency must be _______ percent.
   A) appreciation; 4
   B) appreciation; 2
   C) depreciation; 2
   D) depreciation; 4
   Answer: B
   Ques Status: Revised

18) According to the interest parity condition, if the domestic interest rate is 10 percent and the foreign interest rate is 12 percent, then the expected _______ of the foreign currency must be _______ percent.
   A) appreciation; 4
   B) appreciation; 2
   C) depreciation; 2
   D) depreciation; 4
   Answer: C
   Ques Status: Revised

19) Everything else held constant, when the current value of the domestic currency increases, the _______ domestic assets _______.
   A) demand for; increases
   B) quantity demanded of; increases
   C) demand for; decreases
   D) quantity demanded of; decreases
   Answer: D
   Ques Status: New

20) Everything else held constant, when the current value of the domestic exchange rate increases, the _______ of domestic assets _______.
   A) quantity supplied; does not change
   B) supply; decreases
   C) quantity supplied; increases
   D) supply; increases
   Answer: A
   Ques Status: New
21) Explain the interest parity condition. What key assumption underlies this condition? What factors affect the returns on domestic and foreign assets?

Answer: The interest parity condition states that returns on domestic and foreign assets will be equal. The key assumption for this condition is capital mobility. The return on domestic assets is equal to the domestic interest rate. The return on foreign assets is equal to the foreign interest rate minus the expected rate of appreciation of the domestic currency.

17.4 Explaining Changes in Exchange Rates

1) An increase in the domestic interest rate causes the demand for domestic assets to _______ and the domestic currency to _______, everything else held constant.
   A) increase; appreciate
   B) increase; depreciate
   C) decrease; appreciate
   D) decrease; depreciate

Answer: A

Ques Status: New

2) An increase in the domestic interest rate causes the demand for domestic assets to shift to the _______ and the domestic currency to _______, everything else held constant.
   A) right; appreciate
   B) right; depreciate
   C) left; appreciate
   D) left; depreciate

Answer: A

Ques Status: New

3) A decrease in the domestic interest rate causes the demand for domestic assets to _______ and the domestic currency to _______, everything else held constant.
   A) increase; appreciate
   B) increase; depreciate
   C) decrease; appreciate
   D) decrease; depreciate

Answer: D

Ques Status: New
4) A decrease in the domestic interest rate causes the demand for domestic assets to shift to the _______ and the domestic currency to _______, everything else held constant.
   A) right; appreciate  
   B) right; depreciate  
   C) left; appreciate  
   D) left; depreciate  

   Answer: D  
   Ques Status: New

5) _______ in the domestic interest rate causes the demand for domestic assets to increase and the domestic currency to _______, everything else held constant.
   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate  

   Answer: A  
   Ques Status: New

6) _______ in the domestic interest rate causes the demand for domestic assets to shift to the right and the domestic currency to _______, everything else held constant.
   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate  

   Answer: A  
   Ques Status: New

7) _______ in the domestic interest rate causes the demand for domestic assets to decrease and the domestic currency to _______, everything else held constant.
   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate  

   Answer: D  
   Ques Status: New
8) ______ in the domestic interest rate causes the demand for domestic assets to shift to the left and the domestic currency to ______, everything else held constant.
   A) An increase; appreciate
   B) An increase; depreciate
   C) A decrease; appreciate
   D) A decrease; depreciate

Answer: D
Ques Status: New

9) ______ in the domestic interest rate causes the demand for domestic assets to ______ and the domestic currency to appreciate, everything else held constant.
   A) An increase; increase
   B) An increase; decrease
   C) A decrease; increase
   D) A decrease; decrease

Answer: A
Ques Status: New

10) ______ in the domestic interest rate causes the demand for domestic assets to shift to the ______ and the domestic currency to appreciate, everything else held constant.
   A) An increase; right
   B) An increase; left
   C) A decrease; right
   D) A decrease; left

Answer: A
Ques Status: New

11) ______ in the domestic interest rate causes the demand for domestic assets to ______ and the domestic currency to depreciate, everything else held constant.
   A) An increase; increase
   B) An increase; decrease
   C) A decrease; increase
   D) A decrease; decrease

Answer: D
Ques Status: New
12) ________ in the domestic interest rate causes the demand for domestic assets to shift to the ________ and the domestic currency to depreciate, everything else held constant.
   
   A) An increase; right
   B) An increase; left
   C) A decrease; right
   D) A decrease; left

   Answer: D  
   Ques Status: New

13) Suppose that the Federal Reserve enacts expansionary policy. Everything else held constant, this will cause the demand for U.S. assets to ________ and the U.S. dollar to ________.
   
   A) increase; appreciate
   B) decrease; appreciate
   C) increase; depreciate
   D) decrease; depreciate

   Answer: D  
   Ques Status: New

14) Suppose that the Federal Reserve conducts an open market sale. Everything else held constant, this will cause the demand for U.S. assets to ________ and the U.S. dollar will ________.
   
   A) increase; appreciate
   B) increase; depreciate
   C) decrease; appreciate
   D) decrease; depreciate

   Answer: A  
   Ques Status: New

15) An increase in the foreign interest rate causes the demand for domestic assets to ________ and the domestic currency to ________, everything else held constant.
   
   A) increase; appreciate
   B) increase; depreciate
   C) decrease; appreciate
   D) decrease; depreciate

   Answer: D  
   Ques Status: New
16) An increase in the foreign interest rate causes the demand for domestic assets to shift to the _______ and the domestic currency to _______, everything else held constant.

   A) right; appreciate
   B) right; depreciate
   C) left; appreciate
   D) left; depreciate

   Answer: D
   Ques Status: New

17) A decrease in the foreign interest rate causes the demand for domestic assets to _______ and the domestic currency to _______, everything else held constant.

   A) increase; appreciate
   B) increase; depreciate
   C) decrease; appreciate
   D) decrease; depreciate

   Answer: A
   Ques Status: New

18) A decrease in the foreign interest rate causes the demand for domestic assets to shift to the _______ and the domestic currency to _______, everything else held constant.

   A) right; appreciate
   B) right; depreciate
   C) left; appreciate
   D) left; depreciate

   Answer: A
   Ques Status: New

19) _______ in the foreign interest rate causes the demand for domestic assets to increase and the domestic currency to _______, everything else held constant.

   A) An increase; appreciate
   B) An increase; depreciate
   C) A decrease; appreciate
   D) A decrease; depreciate

   Answer: C
   Ques Status: New
20) _______ in the foreign interest rate causes the demand for domestic assets to shift to the right and the domestic currency to ________, everything else held constant.

A) An increase; appreciate  
B) An increase; depreciate  
C) A decrease; appreciate  
D) A decrease; depreciate  

Answer: C  
Ques Status: New  

21) _______ in the foreign interest rate causes the demand for domestic assets to decrease and the domestic currency to ________, everything else held constant.

A) An increase; appreciate  
B) An increase; depreciate  
C) A decrease; appreciate  
D) A decrease; depreciate  

Answer: B  
Ques Status: New  

22) _______ in the foreign interest rate causes the demand for domestic assets to shift to the left and the domestic currency to ________, everything else held constant.

A) An increase; appreciate  
B) An increase; depreciate  
C) A decrease; appreciate  
D) A decrease; depreciate  

Answer: B  
Ques Status: New  

23) _______ in the foreign interest rate causes the demand for domestic assets to _______ and the domestic currency to appreciate, everything else held constant.

A) An increase; increase  
B) An increase; decrease  
C) A decrease; increase  
D) A decrease; decrease  

Answer: C  
Ques Status: New
24) ______ in the foreign interest rate causes the demand for domestic assets to shift to the ______ and the domestic currency to appreciate, everything else held constant.
   A) An increase; right
   B) An increase; left
   C) A decrease; right
   D) A decrease; left

Answer: C  
Ques Status: New

25) ______ in the foreign interest rate causes the demand for domestic assets to ______ and the domestic currency to depreciate, everything else held constant.
   A) An increase; increase
   B) An increase; decrease
   C) A decrease; increase
   D) A decrease; decrease

Answer: B  
Ques Status: New

26) ______ in the foreign interest rate causes the demand for domestic assets to shift to the ______ and the domestic currency to depreciate, everything else held constant.
   A) An increase; right
   B) An increase; left
   C) A decrease; right
   D) A decrease; left

Answer: B  
Ques Status: New

27) Suppose that the European Central Bank enacts expansionary policy. Everything else held constant, this will cause the demand for U.S. assets to ______ and the U.S. dollar to ______.
   A) increase; appreciate
   B) decrease; appreciate
   C) increase; depreciate
   D) decrease; depreciate

Answer: A  
Ques Status: New
28) Suppose that the European Central Bank conducts a main refinancing sale. Everything else held constant, this would cause the demand for U.S. assets to _______ and the U.S. dollar will _______.

A) increase; appreciate  
B) increase; depreciate  
C) decrease; appreciate  
D) decrease; depreciate

Answer: D

Ques Status: New

29) An increase in the expected future domestic exchange rate causes the demand for domestic assets to _______ and the domestic currency to _______, everything else held constant.

A) increase; appreciate  
B) increase; depreciate  
C) decrease; appreciate  
D) decrease; depreciate

Answer: A

Ques Status: New

30) An increase in the expected future domestic exchange rate causes the demand for domestic assets to shift to the _______ and the domestic currency to _______, everything else held constant.

A) right; appreciate  
B) right; depreciate  
C) left; appreciate  
D) left; depreciate

Answer: A

Ques Status: New

31) A decrease in the expected future domestic exchange rate causes the demand for domestic assets to _______ and the domestic currency to _______, everything else held constant.

A) increase; appreciate  
B) increase; depreciate  
C) decrease; appreciate  
D) decrease; depreciate

Answer: D

Ques Status: New
32) A decrease in the expected future domestic exchange rate causes the demand for domestic assets to shift to the ______ and the domestic currency to ______, everything else held constant.

   A) right; appreciate  
   B) right; depreciate  
   C) left; appreciate  
   D) left; depreciate

   Answer: D  
   Ques Status: New

33) ______ in the expected future domestic exchange rate causes the demand for domestic assets to increase and the domestic currency to ______, everything else held constant.

   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate

   Answer: A  
   Ques Status: New

34) ______ in the expected future domestic exchange rate causes the demand for domestic assets to shift to the right and the domestic currency to ______, everything else held constant.

   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate

   Answer: A  
   Ques Status: New

35) ______ in the expected future domestic exchange rate causes the demand for domestic assets to decrease and the domestic currency to ______, everything else held constant.

   A) An increase; appreciate  
   B) An increase; depreciate  
   C) A decrease; appreciate  
   D) A decrease; depreciate

   Answer: D  
   Ques Status: New
36) ________ in the expected future domestic exchange rate causes the demand for domestic assets to shift to the left and the domestic currency to ________, everything else held constant.
   A) An increase; appreciate
   B) An increase; depreciate
   C) A decrease; appreciate
   D) A decrease; depreciate
   Answer: D
   Ques Status: New

37) ________ in the expected future domestic exchange rate causes the demand for domestic assets to ________ and the domestic currency to appreciate, everything else held constant.
   A) An increase; increase
   B) An increase; decrease
   C) A decrease; increase
   D) A decrease; decrease
   Answer: A
   Ques Status: New

38) ________ in the expected future domestic exchange rate causes the demand for domestic assets to shift to the ________ and the domestic currency to appreciate, everything else held constant.
   A) An increase; right
   B) An increase; left
   C) A decrease; right
   D) A decrease; left
   Answer: A
   Ques Status: New

39) ________ in the expected future domestic exchange rate causes the demand for domestic assets to ________ and the domestic currency to depreciate, everything else held constant.
   A) An increase; increase
   B) An increase; decrease
   C) A decrease; increase
   D) A decrease; decrease
   Answer: D
   Ques Status: New
40) _______ in the expected future domestic exchange rate causes the demand for domestic assets to shift to the _______ and the domestic currency to depreciate, everything else held constant.

A) An increase; right
B) An increase; left
C) A decrease; right
D) A decrease; left

Answer: D

Ques Status: New

41) Suppose the Federal Reserve releases a policy statement today which leads people to believe that the Fed will be enacting expansionary monetary policy in the near future. Everything else held constant, the release of this statement would immediately cause the demand for U.S. assets to _______ and the U.S. dollar to _______.

A) increase; appreciate
B) decrease; appreciate
C) increase; depreciate
D) decrease; depreciate

Answer: D

Ques Status: New

42) Suppose a report was released today that showed the Euro-Zone inflation rate is running above the European Central Bank’s inflation rate target. This leads people to expect that the European Central Bank will enact contractionary policy in the near future. Everything else held constant, the release of this report would immediately cause the demand for U.S. assets to _______ and the U.S. dollar will _______.

A) increase; appreciate
B) increase; depreciate
C) decrease; appreciate
D) decrease; depreciate

Answer: A

Ques Status: New

43) Suppose that the latest Consumer Price Index (CPI) release shows a higher inflation rate in the U.S. than was expected. Everything else held constant, the release of the CPI report would immediately cause the demand for U.S. assets to _______ and the U.S. dollar would _______.

A) increase; appreciate
B) increase; depreciate
C) decrease; appreciate
D) decrease; depreciate

Answer: D

Ques Status: New
44) In the long run, a one-time percentage increase in the money supply is matched by the same one-time percentage rise in the price level, leaving unchanged the real money supply and ________. This proposition is called money ________.

A) other economic variables such as interest rates; neutrality
B) the nominal exchange rate; neutrality
C) all other economic variables such as interest rates; illusion
D) the nominal exchange rate; illusion

Answer: A

45) Money neutrality means that in the long run the domestic interest rate remains unchanged from an increase in the money supply, implying that the fall in the exchange rate is greater in the ________ run than in the ________ run, a phenomenon called exchange rate overshooting.

A) short; short
B) short; long
C) long; short
D) long; long

Answer: B

46) Evidence from the United States during the period 1973–2002 indicates that the value of the dollar and the measure of the ________ interest rate rose and fell together.

A) real
B) nominal
C) expected
D) actual

Answer: A
47) Explain and show graphically the effect of an increase in the expected future exchange rate on the equilibrium exchange rate, everything else held constant.

Answer: See figure below.

When the expected future exchange rate increases, the relative expected return on the domestic assets increases. This will cause the demand for domestic assets to increase and the current value of the exchange rate will appreciate.

*Ques Status: Revised*
48) Explain and show graphically the effect of an increase in the expected inflation rate on the equilibrium exchange rate, everything else held constant.

Answer: See figure below.

When the expected inflation rate increases, the relative expected return on domestic assets is affected two ways. First, through the Fisher effect, the domestic nominal interest rate will increase the expected return on domestic assets. Second, through purchasing power parity, the future value of the domestic exchange rate will decline which will decrease the expected return on domestic assets. Since it is generally believed that the effect of the change in the expected future value of the domestic exchange rate is larger than the Fisher effect, the net effect is a lower expected return on domestic assets. This will decrease the demand for domestic assets, which will cause the current value of the domestic exchange rate to depreciate.

Ques Status: Revised