Week 2 Homework

Chapter 4

1) **Percentage Depreciation** Assume the spot rate of the British pound is $1.73. The expected spot rate 1 year from now is assumed to be $1.66. What percentage depreciation does this reflect?

Percent Change = $(S-S_{t-1})/S_{t-1}$= (1.66-1.73)/1.73= -.07/1.73 = - 4.046% change

2) **Inflation Effects on Exchange Rates** Assume that the U.S. inflation rate becomes high relative to Canadian inflation. Other things being equal, how should this affect the (a) U.S. demand for Canadian dollars, (b) supply of Canadian dollars for sale, and (c) equilibrium value of the Canadian dollar?

12a) The demand for Canadian dollar will increase has the price for products is lower through Canadian trade instead of national trade in the US.

12b) The supply will decrease because of the demand for the currency increasing.

12c) The equilibrium value of the Canadian dollar with then increase do the shortage and demand for the currency.

6) **Effects of Real Interest Rates** What is the expected relationship between the relative real interest rates of two countries and the exchange rate of their currencies?

The effects of interest rates between two currencies are as follows the currency that has a change in the relative to the other determines the flow of value, the country that has the higher change of relativity is the one that will get more investing and demand for currency. Whereas the lower end will have a sale of their currency and less of a demand dropping its value.

Chapter 5)

1) **Forward versus Futures Contracts** Compare and contrast forward and futures contracts.

They are both similar in that they are contracts that have a set date of completion but the way the operate and are exchanged are different. Forward contracts are amounts that are exchanged at set dates and at a set rate and this is done between two parties, where as future contracts are that a set amount of currency will be exchanged by a set date and is done through a public exchange

3) **Currency Options** Differentiate between a currency call option and a currency put option.

The difference between the types of options is the call option is having the ability to buy a currency at a specified rate from a particular source within a time frame and limit, where the put option is just the opposite it’s the selling of a currency to a specific location within a time frame or limit.

Chapter 6)

1) **Exchange Rate Systems** Compare and contrast the fixed, freely floating, and managed float exchange rate systems. What are some advantages and disadvantages of a freely floating exchange rate system versus a fixed exchange rate system?