

**Problem-solving based assessment**

Friday 13<sup>th</sup> December 2019, 2pm-4pm

BUSM041 International Macro-Economics and Finance

Duration: 2 hours

**YOU ARE NOT PERMITTED TO READ THE CONTENTS OF THIS QUESTION PAPER UNTIL INSTRUCTED TO DO SO BY AN INVIGILATOR.**

There are **THREE** sections in this paper, section A, section B and, section C. There are 18 questions altogether.

**Section A – QUESTIONS 1 to 10: To be completed in the check boxes provided on screen**

Answer **ALL 10** questions in section A (20 marks).

For the true and false questions, choose the best answer for each question and mark the letter of your selection in the space provided.

Each correct answer will be awarded 2 marks.

Each incorrect answer will be given zero points.

**Section B - QUESTIONS 11 to 16: To be completed in the space provided on screen**

Answer **ALL 6** questions in section B (60 marks).

Each correct answer will be awarded 10 marks.

Each incorrect answer will be given zero points.

**Section C - QUESTIONS 17 to 18: To be completed in the space provided on screen**

Answer **All 2** questions in section C (20 marks). Essay type questions require well-focused and concise answers (10 marks each).

This is an open book assessment.

Use of textbooks and personal notes is permitted during the exam.

Calculators ARE permitted in this examination.

Access to the internet or stored web sites is prohibited and constitutes an assessment offence.

Important note: The Academic Regulations state that use of unauthorised material at any time when a student is under examination conditions is an ASSESSMENT OFFENCE AND CAN LEAD TO EXPULSION FROM THE COLLEGE.

ASSESSMENT PAPERS CANNOT BE REMOVED FROM THE ASSESSMENT ROOM

**Examiner: Prof. Brigitte Granville**

**MA./MSc. by course examination units****INTERNATIONAL MACRO ECONOMICS AND FINANCE BUSM041**

---

**Section A. – QUESTIONS 1 to 10: For the true and false questions, choose the best answer for each question in the space provided. For the problem question, indicate your answer in the space provided.**

Answer **ALL** questions in section A (20 marks).

Each correct answer will be awarded 2 marks

Each incorrect answer will be given zero points.

.

**1. The interest rate measures the opportunity cost of holding money**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q1**\_\_\_\_\_

**2. Currency is not a liquid asset**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q2**\_\_\_\_\_

**3. An increase in a country's money supply causes its currency to depreciate in the foreign exchange market, while a reduction in the money supply causes its currency to appreciate.**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q3**\_\_\_\_\_

**4. An economy's long-run equilibrium is the equilibrium that would occur if prices were perfectly fixed at the full employment point**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q4**\_\_\_\_\_

**5. In a classic paper, Columbia University economist Phillip Cagan drew the line between inflation and hyperinflation at an inflation rate of 5 percent per month.**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q5**\_\_\_\_\_

**6. If people expect relative PPP to hold, the difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected, in the United States and Europe, over the relevant horizon.**

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q6**\_\_\_\_\_

7. The existence of non-tradable goods allow for deviations from Purchasing Power Parity?

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q7**\_\_\_\_\_

8. By fixing the exchange rate, the central bank gives up its ability to influence the economy through monetary policy.

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q8**\_\_\_\_\_

9. Financial markets promote economic efficiency by creating inflation.

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q9**\_\_\_\_\_

10. The stock market is important because it is where interest rates are determined.

- (a) TRUE
- (b) FALSE

[2 marks] **Answer to Q10**\_\_\_\_\_

**End of Section A**

**Section B. QUESTIONS 11 to 16: Mark your answer for each question in the space provided on screen**

Answer **ALL** questions in section B (60 marks).

Each correct answer will be awarded 10 marks

Each incorrect answer will be given zero points.

**11.**

- **11a.** Suppose that the one-year forward price of euros in terms of dollars is equal to \$1.113 per euro. Further, assume that the spot exchange rate is \$1.05 per euro, and the interest rate on dollar deposits is 10 percent and on euros it is 4 percent. What is the rate of return on a covered euro deposit?

[5 marks] **Answer to Q11a**\_\_\_\_\_

- **11b.** Assume that  $R$  denotes the domestic interest rate and  $R^*$  denotes the foreign interest rate. Under a fixed exchange rate, what is the relation between  $R$  and  $R^*$ ?

[5 marks] **Answer to Q11b**\_\_\_\_\_

12.

- **12a.** What is the exchange rate between the dollar and the British pound if a pair of American jeans costs 60 dollars in New York and 30 pounds in London?

[5 marks] **Answer to Q12a**\_\_\_\_\_

- **12b.** If the dollar interest rate is 10 percent, the euro interest rate is 6 percent, and the expected return on dollar depreciation against the euro is 4 percent, then should you invest in dollars or in euros?

[5 marks] **Answer to Q14**\_\_\_\_\_

13.

- **13a.** Compute how many dollars it would cost to buy an Edinburgh Woolen Mill sweater costing 50 British pounds for the following exchange rates:

Exchange Rate	Price of a sweater in British pounds	Price in dollars
Number of dollars per one British pound		
1	50	
1.1	50	

[8 marks] **Answer to Q13a**\_\_\_\_\_

- **13b.** Suppose Russia's inflation rate is 200% over one year, but the inflation rate in Switzerland is only 2%. According to relative PPP, what should happen over the year to the Swiss franc's exchange rate against the Russian ruble?
  1. Appreciation of the swiss franc?
 Or a
  2. Depreciation of the swiss franc?

[2 marks] **Answer to Q13b.**\_\_\_\_\_

14.

- **14a.** With an interest rate of 8 percent, the present value of \$100 next year is?

[5 marks] **Answer to Q14a**\_\_\_\_\_

- **14b.** If the representative basket of European goods and services costs 40 euros, the representative U.S. basket costs \$50, and the dollar/euro exchange rate is \$0.90 per euro, then the price of the European basket in terms of the U.S. basket is

[5 marks] **Answer to Q14b**\_\_\_\_\_

**15.** Suppose you are offered a gamble in which you win \$1,000 half the time but lose \$1,000 half the time. Calculate the average payoff of the gamble. If you are a risk averter, will you take the gamble?

[10 marks] **Answer to Q15**\_\_\_\_\_

**16.** Assuming that you borrow \$1000 at 10% annual interest to finance a new business project. For this loan to be profitable, the minimum amount this project must generate in annual earnings is?

[2 marks] **Answer to Q16**\_\_\_\_\_

**End of Section B**

*(Continued on the next page)*

**Section C - QUESTIONS 17 to 18: To be completed in the space provided on screen**

Answer TWO essay type questions. (10 marks each).

**17.** Identify five categories of factors that can trigger financial crises. Give some examples to illustrate your argument.

[10 marks] **Answer to Q17**\_\_\_\_\_


**18.** What is a stock? How do stocks affect the economy? Give an example

[10 marks] **Answer to Q18**\_\_\_\_\_

**Please explain your answers in the space provided below.**


**End of Assessment paper**  
**Name of examiner: Prof. Brigitte Granville**