MSc Examination

xx May 2016   14:30 - 16:30

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 15 questions altogether.

Section A – QUESTIONS 1 to 5: To be completed in the check boxes provided on screen

Answer **ALL 5** questions in section A (10 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 6 to 10: To be completed in the space provided on screen

Answer **ALL 5** questions in section B (40 marks).

Each correct answer will be awarded 8 marks.

Each incorrect answer will be given zero points.

Section C - QUESTIONS 11 to 15: To be completed in the space provided on screen

Answer FIVE essay type questions available in section C (10 marks each).

CALCULATORS ARE PERMITTED IN THIS EXAMINATION. PLEASE STATE ON YOUR ANSWER BOOK THE NAME AND TYPE OF MACHINE USED.

COMPLETE ALL ROUGH WORKINGS IN THE ANSWER BOOK AND CROSS THROUGH ANY WORK WHICH IS NOT TO BE ASSESSED.

IMPORTANT NOTE: THE ACADEMIC REGULATIONS STATE THAT POSSESSION 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. PLEASE CHECK NOW TO ENSURE YOU DO NOT HAVE ANY NOTES IN YOUR POSSESSION. IF YOU HAVE ANY THEN PLEASE RAISE YOUR HAND AND GIVE THEM TO AN INVIGILATOR IMMEDIATELY.

ASSESSMENT PAPERS CANNOT BE REMOVED FROM THE ASSESSMENT ROOM

Examiners: Professor Brigitte Granville;

Section A. – QUESTIONS 1 to 5: For the true and false questions, choose the best answer for each question in the space provided.
Answer **ALL questions** in section A (10 marks).
Each correct answer will be awarded 2 marks
Each incorrect answer will be given zero points.

1. Since the early 1990s, most central banks in mature economies have conducted monetary policy by setting a target for the level of borrowed reserves.

   (a) TRUE
   (b) FALSE

                 [2 marks] **Answer to Q1____**

2. Moral Hazard in financial markets is the risk (HAZARD) that the borrower might engage in activities that are undesirable (immoral) from the lender's point of view because they make it less likely that the loan will be paid back.

   (a) TRUE
   (b) FALSE

                 [2 marks] **Answer to Q2____**

3. If there is initially excess supply of money, the interest rate falls, and if there is initially an excess demand, it rises.

   (a) TRUE
   (b) FALSE

                 [2 marks] **Answer to Q3____**

4. High inflation can spiral out of control when expected inflation decreases nominal interest rates, causing the central bank to buy bonds, increasing the money supply and further increasing inflation.

   (a) TRUE
   (b) FALSE

                 [2 marks] **Answer to Q4____**

5. The government budget surplus equals net government receipts minus government purchases

   (a) TRUE
   (b) FALSE

                 [2 marks] **Answer to Q5____**

  End of Section A

Section B. QUESTIONS 6 to 10: Mark your answer for each question in the space provided on screen
Answer **ALL** questions in section B (30 marks).
Each correct answer will be awarded 6 marks
Each incorrect answer will be given zero points.

6. With an interest rate of 8 percent, the present value of £150 next year is:

[8 marks] **Answer to Q6____**

7. The condition that the expected returns on deposits of any two currencies are equal when measured in the same currency is called the interest parity condition. It implies that potential holders of foreign currency deposits view them as equally desirable assets, i.e. risk is assumed away. In notational forms:

$$R_\$ = R_E + (E^e_{\$/€} - E_{\$/E})/E_{\$/E}$$

Calculate the interest rate $R_\$$ in the United States, if interest parity condition holds, for the following 6 cases:

Case	R€	E	R$
1	0.06	0.04	
2	0.06	0.08	
3	0.12	-0.04	
4	0.18	0	
5	0.06	0	
6	0.06	0.04	

[8 marks] **Answer to Q7____**

8. A loan of $100 today requires the borrower to repay the $100 a year at an interest payment of $10. What is the measure of the simple interest rate:

[8 marks] **Answer to Q8____**

9. Your bank offers you a Certificate of Deposit with 3% interest rate for five year investment. You wish to invest £1500 for five years. How much your investment will be worth then?

[8 marks] **Answer to Q9____**

10. Assuming initially that the required reserve ratio, r = 15%, the currency ratio, c = 40%, and the excess reserves ratio, e = 5%.
   1. calculate the money multiplier
   2. Calculate the money multiplier when e increase to 10%

[8 marks] **Answer to Q10____**

End of Section B

Section C - QUESTIONS 11 to 15: To be completed in the space provided on screen
Answer FIVE essay type questions available in section C. (10 marks each).

11. Explain why in a pure flexible exchange rate system, the foreign exchange market has no direct effects on the money supply? Does this mean that the foreign exchange market has no effect on monetary policy?

[10 marks] **Answer to Q11____**

12. Discuss: Are long term bonds considered a safe asset?

[10 marks] **Answer to Q12____**

13. In the early 1980s, Brazil's government, through an average inflation rate of 147 per cent per year, got only 1.0 per cent of output as seigniorage, while Sierra Leone's government got 2.4 per cent through an inflation rate less than a third as high as Brazil's. Can you think of differences in financial structure that might partially explain this contrast? (Hint: In Sierra Leone, the ratio of currency to nominal output averaged 7.7 per cent; in Brazil, it averaged only 1.4 per cent.)

[10 marks] **Answer to Q13____**

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

[10 marks] **Answer to Q14____**

15. Explain the 1992 crisis that led to the breakdown of the European Union's Exchange Rate Mechanism. What disadvantages of exchange-rate targeting were exhibited during this crisis?

[10 marks] **Answer to Q15____**

End of assessment paper