Queen Mary
University of London

May Examination Period 2024-25

ECN209 International Finance *Duration: 2 hours*

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Answer ALL questions

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SECTION A

Answer True or False to the following 3 statements (questions 1-3). Explain your answer.

Question 1

“If the exchange rate market is at equilibrium and relative Purchasing Power Parity (PPP) holds, then the difference between the domestic and the foreign interest rates is equal to the difference between the expected inflation at home and the expected inflation abroad.”

[10 marks]

Question 2

“Investors buy futures contracts to avoid losses due to unexpected changes in the value of the currency.”

[10 marks]

Question 3

“Absolute Purchasing Power Parity (PPP) may be valid even when relative PPP is not.”

[10 marks]

SECTION B

Question 4

Suppose a permanent increase in the money supply raises real output in the short run. Is it likely the exchange rate will undershoot its long-run equilibrium value? Explain your answer.

[20 marks]

Question 5

“In September 2004, the Bank of Japan (BoJ) reported that the overnight interest rate was 0.001% per year. The BoJ governor publicly stated that expanding the money supply was just as effective as tax cuts in reducing the economy’s unemployment rate.” Comment.

[20 marks]

Question 6

Consider the AA-DD model under a flexible exchange rate regime, with the economy initially at full employment.

a) If a temporary shock to money demand causes a recession, describe a policy intervention that would restore the economy to its pre-shock equilibrium.

[10 marks]

b) How would your response change if the temporary shock instead originated in the goods market?

[10 marks]

c) Suppose the government announces a permanent increase in annual spending of $10 billion on its space program. What impact would this announcement have on output and the exchange rate?

[10 marks]

End of Examination/ Dr. Nikolaos Kokonas