FOREIGN EXCHANGE

MULTIPLE-CHOICE QUESTIONS

1. Assume you are an American exporter and expect to receive 50 pounds sterling at the end of 60 days. You
can remove the risk of loss due to a devaluation of the pound sterling by:
    a. Selling sterling in the forward market for 60-day delivery
    b. Buying sterling now and selling it at the end of 60 days
    c. Selling the dollar equivalent in the forward market for 60-day delivery
    d. Keeping the sterling in Britain after it is delivered to you

2. Which of the following tends to cause the U.S. dollar to *appreciate* in value?
    a. An increase in U.S. prices above foreign prices
    b. Rapid economic growth in foreign countries
    c. A fall in U.S. interest rates below foreign levels
    d. An increase in the level of U.S. income

3. Concerning the covering of exchange market risks—assuming that a *depreciation* of the domestic currency
is anticipated, one can say that there is an incentive for:
    a. Exporters to rush to cover their future needs
    b. Importers to rush to cover their future needs
    c. Both exporters and importers to rush to cover their future needs
    d. Neither exporters nor importers to rush to cover their future needs

4. When short-term interest rates become *lower* in Tokyo than in New York, interest arbitrage operations will
most likely result in a (an):
    a. Increase in the spot price of the yen
    b. Increase in the forward price of the dollar
    c. Sale of dollars in the forward market
    d. Purchase of yen in the spot market

5. An *appreciation* in the value of the U.S. dollar against the British pound would tend to:
    a. Discourage the British from buying American goods
    b. Discourage Americans from buying British goods
    c. Increase the number of dollars that could be bought with a pound
    d. Discourage U.S. tourists from traveling to Britain

6. Concerning the foreign exchange market, one can *best* say that:
    a. There is a spot market for virtually every currency in the world
    b. The market is highly centralized like the stock exchange
    c. Most foreign exchange payments are made with bank notes
    d. The values of the forward and spot rates are always in agreement

7. Suppose researchers discover that Swiss beer causes cancer when given in large amounts to British mice.
This finding would likely result in a (an):
    a. Increase in the demand for Swiss francs
    b. Decrease in the demand for Swiss francs
    c. Increase in the supply of Swiss francs
    d. Decrease in the supply of Swiss francs

8. Suppose that real incomes increase more rapidly in the United States than in Mexico. In the United States,
this situation would likely result in a (an):
   a. Increase in the demand for pesos
   b. Decrease in the demand for pesos
   c. Increase in the supply of pesos
   d. Decrease in the supply of pesos

9. A *depreciation* of the dollar refers to a (an):
   a. Fall in the dollar price of foreign currency
   b. Increase in the dollar price of foreign currency
   c. Loss of foreign-exchange reserves for the U.S.
   d. Intervention in the international money market

10. If Canadian speculators believed the Swiss franc was going to *appreciate* against the U.S. dollar, they
would:
   a. Purchase Canadian dollars
   b. Purchase U.S. dollars
   c. Purchase Swiss francs
   d. Sell Swiss francs

11. A major *difference* between the spot market and the forward market is that the spot market deals with:
   a. The immediate delivery of currencies
   b. The merchandise trade account
   c. Currencies traded for future delivery
   d. Hedging of international currency risks

12. The exchange rate is kept the same in all parts of the market by:
   a. Forward cover
   b. Hedging
   c. Exchange speculation
   d. Exchange arbitrage

13. If you have a commitment to pay a friend in Britain 1,000 pounds in 30 days, you could remove the risk of
loss due to the appreciation of the pound by:
   a. Buying dollars in the forward market for delivery in 30 days
   b. Selling dollars in the forward market for delivery in 30 days
   c. Buying the pounds in the forward market for delivery in 30 days
   d. Selling the pounds in the forward market for delivery in 30 days

14. An *increase* in the dollar price of other currencies tends to cause:
   a. U.S. goods to be cheaper than foreign goods
   b. U.S. goods to be more expensive than foreign goods
   c. Foreign goods to be more expensive to residents of foreign nations
   d. Foreign goods to be cheaper to residents of the United States

15. The balance on merchandise trade:
   a. Must be negative
   b. Must be positive
   c. Must be zero
   d. May be negative, positive, or zero

16. Which of the following would *not* induce the U.S. demand curve for foreign exchange to shift backward to
the left?
   a. Worsening American tastes for goods produced overseas
   b. Decreasing interest rates in the U.S. compared to those overseas

c. A fall in the level of U.S. income
d. A depreciation in the U.S. dollar against foreign currencies

17. A U.S. export company scheduled to receive 1 million pounds six months from today can hedge its foreign
exchange risk by:
a. Buying today 1 million pounds in the forward market for delivery in six months
b. Buying 1 million pounds in the spot market for delivery in six months
c. Selling 1 million pounds in the spot market for delivery in six months
d. Selling today 1 million pounds in the forward market for delivery in six months

18. Over time, a *depreciation* in the value of a nation's currency in the foreign exchange market will result in:
a. Exports rising and imports falling
b. Imports rising and exports falling
c. Both imports and exports rising
d. Both imports and exports falling

19. Grain shortages in countries that buy large amounts of grain from the United States would increase the
demand for American grain and:
a. Reduce the demand for dollars
b. Increase the demand for dollars
c. Reduce the supply of dollars
d. Increase the supply of dollars

20. Suppose the exchange rate between the Japanese yen and the U.S. dollar is 100 yen per dollar. A Japanese
stereo with a price of 60,000 yen will cost:
a. $60
b. $600
c. $6,000
d. None of the above

21. The supply of foreign currency may be:
a. Upward-sloping
b. Backward-sloping
c. Vertical
d. None of the above

22. Suppose that a Swiss watch that costs 400 francs in Switzerland costs $200 in the United States. The
exchange rate between the franc and the dollar is:
a. 2 francs per dollar
b. 1 franc per dollar
c. $2 per franc
d. $3 per franc

23. In the early 1980s, the Federal Reserve pursued a tight monetary policy. All else being equal, the impact of
that policy was to __________ interest rates in the United States relative to those in Europe and cause the
dollar to __________ against European currencies.
a. Decrease, depreciate
b. Decrease, appreciate
c. Increase, depreciate
d. Increase, appreciate

24. Under a system of floating exchange rates, the Swiss franc would depreciate in value if which of the
following occurs?
   a. Price inflation in France
   b. An increase in U.S. real income
   c. A decrease in the Swiss money supply
   d. Falling interest rates in Switzerland

25. A depreciation of the dollar will have its most pronounced impact on imports if the demand for imports is:
   a. Constant
   b. Inelastic
   c. Elastic
   d. Unitary elastic

26. During the era of dollar appreciation, from 1981 to 1985, a main reason why the dollar did *not* fall in value
was:
   a. Flows of foreign investment into the United States
   b. Rising price inflation in the United States
   c. A substantial decrease in U.S. imports
   d. A substantial increase in U.S. exports

27. Which financial instrument provides a buyer the right to purchase or sell a fixed amount of currency at a
prearranged price, within a few days to a couple of years?
   a. Letter of credit
   b. Foreign currency option
   c. Cable transfer
   d. Bill of exchange

28. Given the foreign currency market for the Swiss franc, the *supply* of francs slopes upward, because as the
dollar price of the franc rises:
   a. America's demand for Swiss merchandise rises
   b. America's demand for Swiss merchandise falls
   c. Switzerland's demand for American merchandise rises
   d. Switzerland's demand for American merchandise falls

29. In a supply-and-demand diagram for Japanese yen, with the exchange rate in dollars per yen on the vertical
axis, the demand schedule for yen is drawn sloping:
   a. Upward
   b. Vertical
   c. Downward
   d. Horizontal

30. Suppose there occurs an increase in the Canadian demand for Japanese computers. This results in:
   a. An increase in the demand for yen
   b. A decrease in the demand for yen
   c. An increase in the supply of yen to Canada
   d. A decrease in the supply of yen to Canada

Table 12.1 gives the exchange rate quotations for the U.S. dollar and the British pound. Answer the next *four* questions on the basis of this information.

Table 12.1. *Foreign Exchange Quotations*

	U.S. Dollar	Equivalent	Currency	per U.S. Dollar
	Tuesday	Monday	Tuesday	Monday
Britain (Pound)	1.4270	1.4390	.7008	.6949
30-day Forward	1.4211	1.4333	.7037	.6977
60-day Forward	1.4090	1.4220	.7097	.7032
180-day Forward	1.3930	1.4070	.7179	.7107

31. Consider Table 12.1. If one were to buy pounds for immediate delivery, on Tuesday the dollar cost of each pound would be:
    a. $0.7008
    b. $0.7037
    c. $1.4211
    d. $1.4270

32. Consider Table 12.1. If one were to sell dollars for immediate delivery, on Tuesday the pound cost of each
    dollar would be:
    a. .7008 pounds per dollar
    b. .7037 pounds per dollar
    c. 1.4270 pounds per dollar
    d. 1.4211 pounds per dollar

33. Consider Table 12.1. Comparing Tuesday to the previous Monday, by Tuesday the dollar had:
    a. Depreciated against the pound
    b. Appreciated against the pound
    c. Not changed against the pound
    d. None of the above

34. Consider Table 12.1. Concerning the Tuesday quotations: compared to the cost of buying 100 pounds on
    the spot market, if 100 pounds were bought for future delivery in 180 days the dollar cost of the pounds
    would be:
    a. $3.40 higher
    b. $3.40 lower
    c. $6.80 higher
    d. $6.80 lower

35. Which method of trading currencies involves the conversion of one currency into another at one point in
    time with an agreement to reconvert it back to the original currency at some point in the future?
    a. Forward transaction
    b. Futures transaction
    c. Spot transaction
    d. Swap transaction

36. Most foreign exchange trading occurs between banks and:
    a. National governments
    b. Other banks
    c. Corporations
    d. Household investors

37. The most important (in terms of dollar value) type of foreign exchange transaction by U.S. banks is the:
    a. Spot transaction
    b. Forward transaction
    c. Swap transaction

d. Option transaction

38. In the interbank market for foreign exchange, the __________ refers to the price that a bank is willing to
pay for a unit of foreign currency.
a. Offer rate
b. Bid rate
c. Spread rate
d. Transaction rate

39. In the interbank market for foreign exchange, the __________ refers to the price for which a bank is
willing to sell a unit of foreign currency.
a. Offer rate
b. Option rate
c. Futures rate
d. Bid rate

40. In the interbank market for foreign exchange, the __________ refers to the difference between the offer
rate and the bid rate.
a. Cross rate
b. Option
c. Arbitrage
d. Spread

41. A corporation dealing in foreign exchange may desire to obtain an exchange quote between the pound and
franc, whose values are both expressed relative to the dollar. _________ are used to determine such a
relationship.
a. Spot exchange rates
b. Forward exchange rates
c. Cross exchange rates
d. Option exchange rates

42. Suppose the exchange value of the British pound is $2 per pound while the exchange value of the Swiss
franc is 50 cents per pound. The cross exchange rate between the pound and the franc is:
a. 1 franc per pound
b. 2 francs per pound
c. 3 francs per pound
d. 4 francs per pound

Assume the following: (1) the interest rate on 6-month treasury bills is 8 percent per annum in the United Kingdom and 4 percent per annum in the United States; (2) today's spot price of the pound is $1.50 while the 6-month forward price of the pound is $1.485. Answer the next *three* questions on the basis of this information.

43. By investing in U.K. treasury bills rather than U.S. treasury bills, and not covering exchange rate risk, U.S.
investors earn an extra return of:
a. 4 percent per year, 1 percent for the 6 months
b. 4 percent per year, 2 percent for the 6 months
c. 2 percent per year, 0.5 percent for the 6 months
d. 2 percent per year, 1 percent for the 6 months

44. If U.S. investors cover their exchange rate risk, the extra return for the 6 months on the U.K. treasury bills
is:

a. 1.0 percent
b. 1.5 percent
c. 2.0 percent
d. 2.5 percent

45. If the price of the 6-month forward pound were to __________, U.S. investors would no longer earn an extra return by shifting funds to the United Kingdom.
a. Rise to $1.52
b. Rise to $1.53
c. Fall to $1.48
d. Fall to $1.47

46. Assume that you are the Chase Manhattan Bank of the United States, and you have 1 million Swiss francs in your vault that you will need to use in 30 days. Moreover, you need 500,000 British pounds for the next 30 days. You arrange to loan your francs to Barclays Bank of London for 30 days in exchange for 500,000 pounds today, and reverse the transaction at the end of 30 days. You have just arranged a:
a. Forward contract
b. Futures contract
c. Spot contract
d. Currency swap

47. Refer to Figure 12.1. At the equilibrium exchange rate of ______ per franc, __________francs will be purchased at a total dollar cost of _________ .
a. $.50, 5 million, $2.5 million
b. $.50, 5 million, $1.5 million
c. $.70, 3 million, $2.1 million
d. $.70, 7 million, $4.9 million

48. Refer to Figure 12.1. Suppose the exchange rate is $.70 per franc. At this exchange rate there is an _________ of francs which leads to a __________in the dollar price of the franc, a (an) _________ in the quantity of francs supplied, and a (an) _________ in the quantity of francs demanded.
a. Excess demand, rise, increase, decrease
b. Excess demand, rise, decrease, increase
c. Excess supply, fall, decrease, increase
d. Excess supply, fall, increase, decrease

49. Refer to Figure 12.1. Suppose the exchange rate is $.30 per franc. At this exchange rate there is an _________ of francs which leads to a __________in the dollar price of the franc, a (an) _________ in the quantity of francs supplied, and a (an) _________ in the quantity of francs demanded.
a. Excess demand, rise, increase, decrease
b. Excess demand, rise, decrease, increase
c. Excess supply, fall, decrease, increase
d. Excess supply, fall, increase, decrease

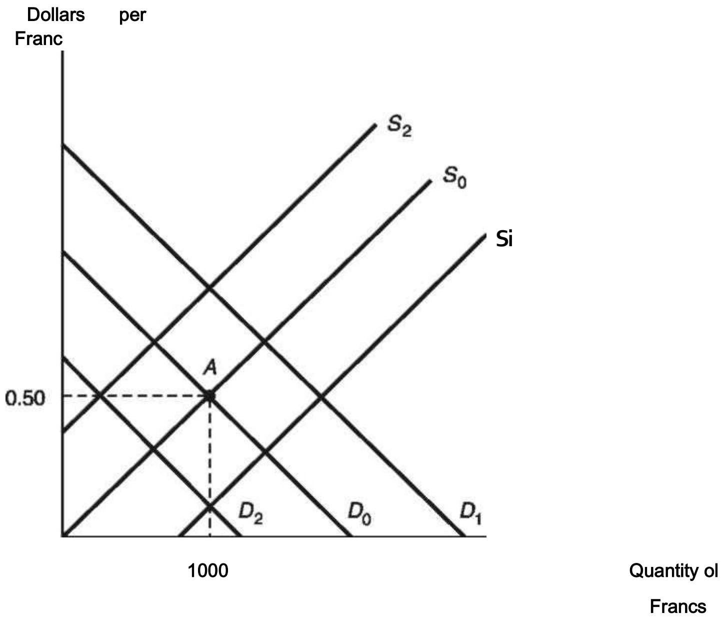
50. Refer to Figure 12.1. Suppose the exchange rate is $.70 per franc. Free-market forces would lead to a (an) _________ of the dollar against the franc and a (an) __________ in U.S. international competitiveness.
a. Depreciation, improvement
b. Depreciation, worsening

c. Appreciation, improvement
d. Appreciation, worsening

51. Refer to Figure 12.1. Suppose the exchange rate is $.30 per franc. Free-market forces would lead to a (an)
__________ of the dollar against the franc and a (an) ___________ in U.S. international competitiveness.
a. Depreciation, improvement
b. Depreciation, worsening
c. Appreciation, improvement
d. Appreciation, worsening

Figure 12.2 illustrates the market for Swiss francs in a world of market-determined exchange rates. Assume the equilibrium exchange rate is $0.5 per franc, given by the intersection of schedules S_0 and D_0. Answer the next *two* questions on the basis of this information.

Figure 12.2. *Market for Francs*



52. Refer to Figure 12.2. A shift in the demand for francs from D_0 to D_1 or a shift in the supply of francs from S_0 to S_2, would result in a (an):
    a. Depreciation in the dollar against the franc
    b. Appreciation in the dollar against the franc
    c. Unchanged dollar/franc exchange rate
    d. None of the above

53. Refer to Figure 12.2. A shift in the demand for francs from D_0 to D_2, or a shift in the supply of francs from S_0 to S_1, would result in a (an):
    a. Depreciation in the dollar against the franc
    b. Appreciation in the dollar against the franc
    c. No change in the dollar/franc exchange rate
    d. None of the above

54. A (an) _________ is an arrangement by which two parties exchange one currency for another and agree that the exchange will be reversed at a stipulated date in the future.
    a. Arbitrage
    b. Swap
    c. Option
    d. Hedge

Answer the next *three* questions on the basis of the information in Table 12.2.

Table 12.2. *Supply and Demand of British Pounds*

Quantity of Pounds Supplied	Dollars per Pound	Quantity of Pounds Demanded
1,000	2.00	200
800	1.80	400
600	1.60	600
400	1.40	800
200	1.20	1,000

55. Refer to Table 12.2. The equilibrium exchange rate equals:
    a. $1.20 per pound
    b. $1.40 per pound
    c. $1.60 per pound
    d. $1.80 per pound

56. Refer to Table 12.2. At the exchange rate of $1.40 per pound, there is an__________ for pounds. This imbalance causes a (an)__________in the price of the pound, which leads to a (an) _________________________in the quantity of pounds supplied and a (an) _________ in the quantity of pounds demanded.
    a. Excess supply, decrease, increase, decrease
    b. Excess supply, increase, decrease, increase
    c. Excess demand, increase, increase, decrease
    d. Excess demand, increase, decrease, increase

57. Refer to Table 12.2. At the exchange rate of $1.80 per pound, there is an__________ for pounds. This imbalance causes a (an)__________in the price of the pound, which leads to a (an) _________________________in the quantity of pounds supplied and a (an) _________ in the quantity of pounds demanded.
    a. Excess supply, decrease, decrease, increase
    b. Excess supply, increase, decrease, increase
    c. Excess demand, increase, increase, decrease
    d. Excess demand, increase, decrease, increase

Using the data of Table 12.3, answer Questions 58 and 59.

Table 12.3. *Key Currency Cross Rates*

	Dollar	Euro	Pound	Swiss Franc
Canada	1.5326	1.4400	2.2362	0.9790
Japan	124.48	116.96	181.63	79.515
Mexico	9.7410	9.1526	14.213	6.2223
Switzerland	1.5655	1.4709	2.2842	—
U.K.	.68540	.6440	—	.4378
Euro	1.06430	—	1.5529	.67984
U.S.	—	.9396	1.4591	.63877

58. Refer to Table 12.3. The cross exchange rate between the euro and Swiss franc is approximately:
   a. .68 euros per franc
   b. .68 francs per euro
   c. .64 euros per franc
   d. .64 francs per euro

59. Refer to Table 12.3. The yen cost of purchasing 100 British pounds is roughly:
   a. 18,000 yen
   b. 19,000 yen
   c. 20,000 yen
   d. 21,000 yen

Using the data of Table 12.4, answer

Questions 60 through 63. **Table**

12.4. *Forward Exchange Rates*

	U.S. Dollar Equivalent	
	Wednesday	Tuesday
Switzerland (Franc)	.6598	.6590
30-day Forward	.6592	.6585
90-day Forward	.6585	.6578
180-day Forward	.6577	.6572

60. Refer to Table 12.4. On Wednesday, the 30-day forward franc was selling at a:
   a. 1 percent premium per annum against the dollar
   b. 2 percent premium per annum against the dollar
   c. 1 percent discount per annum against the dollar
   d. 2 percent discount per annum against the dollar

61. Refer to Table 12.4. On Wednesday, the 90-day forward franc was selling at a:
   a. 0.8 percent premium per annum against the dollar
   b. 1.6 percent premium per annum against the dollar
   c. 0.8 percent discount per annum against the dollar
   d. 1.6 percent discount per annum against the dollar

62. Refer to Table 12.4. On Wednesday, the 180-day forward franc was selling at a:

   a. 0.6 percent premium per annum against the dollar
   b. 1.6 percent premium per annum against the dollar
   c. 0.6 percent discount per annum against the dollar
   d. 1.6 percent discount per annum against the dollar

63. Refer to Table 12.4. Comparing the franc's forward rates against the franc's spot rate, the exchange market's consensus is that over the period of a forward contract, the franc's spot rate will:

   a. Depreciate against the dollar
   b. Appreciate against the dollar
   c. Remain constant against the dollar
   d. None of the above