Review Questions for Final Exam

The format for the final will be similar to the midterms. Thus, some questions may come from, or be similar to, the following list of review/study questions.

1. How are the Law of One Price and Purchasing Power Parity (PPP) related?

2. What are some of the determinants of Long-Run Exchange rate behavior?

3. How might the global supply and demand of oil affect the Russian ruble/US $ exchange rate (ceteris paribus)?

4. How might the global supply and demand of oil affect the Japanese yen/US $ exchange rate (ceteris paribus)?

5. Given that Long-run models of E-rate behavior are not completely realistic, what are they used for?

6. How do relative productivity levels between countries influence the exchange rate (ceteris paribus)?

7. How do trade barriers between countries influence the exchange rate (ceteris paribus)?

8. Define Purchasing Power Parity (PPP). How does it differ from Relative PPP? What are the shortcomings of PPP?

9. Using a supply and demand framework for foreign exchange, describe how the equilibrium exchange rate ($E$) between two countries is determined. Use a graph in your answer.

10. Currently the Euro/US Dollar exchange rate is .8 Euros per 1 US dollar. One forecast for 2015 puts the dollar at parity with the Euro (1 Euro per 1 US dollar). Discuss.

11. In 2014 the head of the Russian Central Bank (RCB) recently announced that the bank would no longer defend the Ruble from depreciating against the US dollar. In the short-run this would indicate no Balance-of-Payments crisis for Russia. In the long-run however, given the current downturn in the Russian economy, a BOP crisis is still a possibility. Discuss.

12. Describe the Impossible Trinity in terms of Central Bank Macro policy options.

13. Which of the two aspects of the trinity is the European Central Bank (ECB) following?

14. What are reasons for a central bank to defend a currency peg? Give an example of a country with a peg and explain why.

15. The US central bank, the Federal Reserve, officially is agnostic on the current value of the dollar relative to other currencies. Discuss.

16. You live in Country A but recently took out a loan in Country B’s currency. With the world economy in a volatile period, why might this be a problem for you in the future?
17. In international finance “Original Sin” is defined as borrowing in a foreign currency. Russian oil firms, for the last few years, have taken out large US dollar- and Euro-denominated loans. Why is this “original sin” proving difficult for them in terms of servicing these loans and how might this affect the Russian government?

18. Since WWII German yearly productivity gains have been, on average, higher than France’s. What would long-run models of exchange rates predict for the (pre-Euro) German mark/French franc exchange rate behavior and why?

19. Exchange rate theory indicates that smaller a country is the more it will want to peg its currency to the US dollar or euro. Discuss.

20. If Country A experiences deflation and Country B experiences inflation, what would you expect to happen to the exchange between the countries’ currencies and why? What theory pertains?

21. What are some characteristics of their country do central banks consider when choosing an exchange rate system to implement?

Also, given that the last class meeting will be devoted to student presentations, make sure you read all the articles posted on the class website.