Matr.-Nr. _____ Name: _____

Examination	**International Macroeconomics and Finance (No. 1293)**
Examiners:	**Prof. Dr. Gerhard Schwödiauer/ Dr. Ludwig von Auer**
Semester:	**Winter Semester 2003/04**
The following aids may be used:	**Non-programmable pocket calculators; English language dictionaries without any marking.**

This exam comprises 25 problems. For each problem exactly one of the three optional answers is correct. Do not mark more than one answer to any of the questions, otherwise the solution will be considered false. For every correct answer you obtain 2 points, for every false answer 1 point is subtracted. If no answer is marked you neither obtain nor lose a point.

Make sure that this copy of the exam bears your matriculation number and name in the appropriate fields at the top of this page!

Examination Questions:

1. The spot exchange rate of the euro is 1,25 $, the 12-months forward rate of the dollar is 0,70 €. This means that there is

   ☐ a) a forward discount on the euro;
   ☐ b) a forward premium on the euro;
   ☐ c) a forward premium on the dollar.

2. For the exchange rates given in problem 1, the CIP condition requires the interest rate on 12-months dollar deposits to be (approximately) 16 % if the interest rate on 12-months euro deposits is

   ☐ a) 1 %;
   ☐ b) 10 %;
   ☐ c) 20 %.

3. The efficient-market hypothesis implies that forward exchange rates are unbiased predictors of future spot rates if the market participants are

- [ ] a) risk averse;
- [ ] b) speculators;
- [ ] c) risk neutral.

4. The Relative Purchasing Power Parity hypothesis claims that

- [ ] a) the real exchange rate between two currencies is constant;
- [ ] b) in the medium run the two currencies' purchasing power is the same;
- [ ] c) in the medium run monetary policies do not affect the real exchange rate between two currencies.

5. Assume that there are strict capital controls but full convertibility for current-account transactions. In the short run (for given GDP) and without central bank intervention, an equilibrium of the foreign exchange market is stable with respect to small shocks if

- [ ] a) export and import exchange-rate elasticities are small;.
- [ ] b) the sum of export and import elasticities is equal to 1;
- [ ] c) the sum of import and export elasticities is bigger than 1.

6. Assume that the value of a country's exports is 40 billion, and there is a trade deficit of 20 billion. The price elasticity of exports is $^3/_4$, that of imports $^1/_3$. A devaluation of the domestic currency will

- [ ] a) improve the trade balance (measured in domestic currency);.
- [ ] b) worsen the trade balance (measured in domestic currency);
- [ ] c) worsen the trade balance (measured in foreign currency).

7. In the US balance-of-payments accounts (where exports are credits, and imports are debits), the purchase of a controlling stake in a German company by a US firm for dollars in cash affects

- [ ] a) the unilateral-transfers account on the debit and the short-term capital account on the credit side;
- [ ] b) the long-term capital account on the debit and the short-term capital account on the credit side;
- [ ] c) the long-term capital account on the credit and the short-term capital account on the debit side.

8. In order to prevent an increase in the spot exchange rate of the domestic currency the central bank may

- [ ] a) raise the short-run interest rate;
- [ ] b) intervene in the forward market buying foreign currency forward;
- [ ] c) intervene in the forward market selling foreign currency forward.

9. If an economy's aggregate saving is bigger than aggregate investment, the country's balance of payments shows

- [ ] a) a surplus on the trade account;
- [ ] b) a surplus on the capital account;
- [ ] c) a deficit on the trade account.

10. Assume that the marginal propensity to consume for a small economy is 0.4, the marginal propensity to import is 0.2, and the marginal tax rate on incomes is 0.5. At a given rate of interest an increase in real exports, due to a fall in the real exchange rate, by 1 billion will increase domestic effective demand (GDP) by

- [ ] a) 0.8 billion;
- [ ] b) 1 billion;
- [ ] c) 1.2 billion.

11. Assume that the economy in problem 10 would be large enough so that a change in its GDP would have a significant effect on the rest of the world. Would in this case the impact of the increase in real exports on domestic GDP be

- [ ] a) bigger than;
- [ ] b) small than;
- [ ] c) the same as

for the small economy?

12. Consider an economy with strict capital controls but full convertibility for current-account transactions. Suppose that the government wishes to minimize the fluctuations of domestic real GDP in the presence of fluctuating domestic investment and volatile foreign demand for domestic output. Which exchange rate regime would be preferable if the volatility of investment is much lower than that of foreign demand?

- [ ] a) Fixed exchange rates.
- [ ] b) Floating exchange rates.
- [ ] c) Does not matter.

13. The Laursen-Metzler-Harberger (LMH) effect claims that current aggregate domestic consumption increases when there is

- ☐ a) a real appreciation of the domestic currency that is expected to be just temporary;
- ☐ b) a real depreciation of the domestic currency that is expected to be just temporary;
- ☐ c) a real depreciation of the domestic currency that is expected to be permanent.

14. In the presence of the LMH-effect the fiscal multiplier of a small open economy with floating exchange rate is

- ☐ a) bigger than;
- ☐ b) small than;
- ☐ c) the same as

without the LMH-effect?

15. "High capital mobility" in the Mundell-Fleming model means that

- ☐ a) the interest elasticity of investment demand is lower than that of the capital account balance;
- ☐ b) the interest elasticity of money demand is lower than that of the capital account balance;
- ☐ c) the interest elasticity of the overall balance of payments (relative to its income elasticity) is higher than the interest elasticity of money demand (relative to its income elasticity).

16. Under a regime of fixed exchange rates and without sterilization by the central bank, the expansionary effect of a rise in government spending is

- ☐ a) higher for low than for high capital mobility;
- ☐ b) higher for high than for low capital mobility;
- ☐ c) independent on the degree of capital mobility.

17. Under a regime of fixed exchange rates, the expansionary effect of a devaluation of the domestic currency

- ☐ a) is bigger for a stronger Laursen-Metzler-Harberger (LMH) effect;
- ☐ b) is smaller for a stronger LMH-effect;
- ☐ c) does not depend on the size of the LMH-effect.

18. A rise in the foreign rate of interest has, if there is some capital mobility,

- ☐ a) an expansionary effect on domestic aggregate demand if the exchange rate is freely floating;
- ☐ b) an expansionary effect on domestic aggregate demand if the exchange rate is kept fixed;
- ☐ c) a contractionary effect on domestic aggregate demand under any exchange rate regime.

19. For a small open economy importing raw materials, an expansionary monetary policy under a regime of floating exchange rates will have

- ☐ a) a contractive effect on short-run aggregate supply;
- ☐ b) an expansive effect on short-run aggregate supply;
- ☐ c) no effect in supply.

20. According to the Dornbusch model, an unanticipated, once-and-for-all increase in the domestic money supply will

- ☐ a) in the longer run cause a fall in the domestic real exchange rate;
- ☐ b) immediately have no effect on the domestic real exchange rate;
- ☐ c) immediately cause the real exchange rate of the domestic currency to fall.

21. The Dornbusch model predicts that a permanent rise in the foreign rate of interest causes the price of foreign currency to rise immediately and in the medium run

- ☐ a) to return to its previous level;
- ☐ b) to fall again but stay above its previous level;
- ☐ c) to fall below its previous level.

22. The Dornbusch model predicts that a permanent rise in real government expenditure will

- ☐ a) change neither the price level nor the real exchange rate in the medium run;
- ☐ b) change neither the price level nor the real exchange rate in the very short run;
- ☐ c) immediately raise the real exchange rate of the domestic currency to its medium-run equilibrium level.

23. The Dornbusch model predicts that an unanticipated permanent increase in the domestic money supply of 10 % will lead to an immediate increase in the price of foreign currency of (10+x) %, where

- ☐ a) $x < 0$ and $-x$ is the bigger the faster economic agents expect the exchange rate to converge to its equilibrium level;
- ☐ b) $x > 0$ and the bigger the smaller is the (semi-)interest elasticity of money demand;
- ☐ c) $x > 0$ and the smaller the more slowly economic agents expect the exchange rate to converge to its equilibrium level.

24. Under a regime of floating exchange rates, an increase in the domestic government's budget deficit will bring about

- ☐ a) a depreciation of the domestic currency;
- ☐ b) an appreciation of the domestic currency for very low capital mobility;
- ☐ c) an appreciation of the domestic currency for sufficiently high capital mobility.

25. The Dornbusch model predicts, in consequence of an expansionary monetary policy, for the medium run a depreciation of the domestic currency which is

- ☐ a) higher than predicted by the relative purchasing power parity (RPPP); hypothesis
- ☐ b) lower than predicted by RPPP;
- ☐ c) equal to the RPPP prediction.

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