Name:________________

1. Is it possible for the balance of payments to show a surplus when a country has imported more goods than it has exported? Please explain.
   No, because Balance of Payments Surplus = taking in more money than paying out
   = supply of foreign money > demand for foreign money
   = exports > imports

2. A. What type of exchange rate system prevailed in the world from the end of WWII to the early 1970s?
   fixed exchange rate system

   B. What international agreement created this exchange rate system?
   Bretton Woods agreement

   C. What type of exchange rate system prevails today?
   Managed floating exchange rate systems

3. Why do expected movements in foreign exchange rates influence the investment decisions of global investors?
   Global investors must always be concerned with changing their holdings back into a domestic currency and face profit/loss with the movements in the exchange rate.

4. Assume that you bank in a system of fixed exchange rates and that you own a lot of Mexican pesos. A rumor starts circulating that Mexico will soon devalue the peso. What will you do? Why?
   Exchange/sell the pesos for another currency until after the devaluation. Then, exchange your holdings back for even more pesos.

5. What will happen to the dollar/Euro exchange rate if the Europeans decide to dump a lot of the U.S. securities that they have purchased over the years?
   Increased Demand for Euros to pay the Europeans for the securities
   = increase in the dollar/Euro exchange rate
   = takes more dollars to equal 1 Euro

6. Suppose 6-month Treasury bills of the U.S. and Europe return 6.5% and 7.4% respectively. If the exchange rate today is 1.82 Euros per dollar, what exchange rate would be necessary for an investor to be indifferent investing in either of the two T-bills?
   Indifference when $1,000,000 * 1.065 = $1,000,000 * 1.82 * 1.074 * 1/r
   Solve for r = 1.83538 Euros/1 dollar

7. List 3 examples of transactions involving receipts of funds by Americans from foreigners.
   Exporting domestic goods
   Foreigners buying domestic stocks, bonds
   Travelling to the U.S.
8. If the U.S. dollar price of a Japanese yen is equal to US$0.25, then what is the Japanese yen price of a U.S. dollar?

\[ \frac{1 \text{ Japanese yen}}{0.25} = \frac{x}{1.00} \]

\[ 0.25x = 1.00 \]

\[ x = \frac{1.00}{0.25} = 4 \text{ yen} = 1 \text{ dollar} \]

9. Under a fixed exchange rate system, a nation that is beginning to run a balance-of-payments deficit would have to do what?

Buy its currency with international reserves

10. A. What are the three factors leading to long run changes in exchange rates?
- Relative prices of US v. Foreign goods (inflation)
- Relative productivity rates (growth)
- Tastes for US v. Foreign goods (increased preference for US w/increased development)

B. What is the leading factor in daily volatility of exchange rates?

Global investors trying to maximize their profits by exchange rate movements