Economics in a Global Context

Test ID: 7659162

Question #1 of 104

Question ID: 413936

Which of the following lists of trading blocs is *most* accurately ordered by degree of economic integration, from least to most integrated?

✓ **A)** **Customs union, economic union, monetary union.**

✗ **B)** Free trade area, economic union, common market.

✗ **C)** Free trade area, common market, customs union.

Explanation

The order by degree of economic integration (from least to most integrated) is as follows: free trade areas, customs union, common market, economic union, and monetary union.

Question #2 of 104

Question ID: 413929

Which of the following groups in the country of Minidonia would *least likely* be helped by the imposition of tariffs on Minidonian imports of transportation equipment?

✗ **A)** **Automotive manufacturers.**

✓ **B)** Trucking companies.

✗ **C)** Minidonia's government.

Explanation

Tariffs on transportation equipment benefit the government in the form of tariff revenue, and benefit domestic producers and industry workers in the form of higher prices for transportation equipment. The users of transportation equipment, such as trucking companies, suffer from higher costs due to the higher prices of transportation equipment.

Question #3 of 104

Question ID: 434262

A currency exchange rate that is set today for an exchange to be made 90 days in the future is *best* described as a:

✓ **A)** **forward exchange rate.**

✗ **B)** spot exchange rate.

✗ **C)** real exchange rate.

Explanation

A forward exchange rate is a currency exchange rate for an exchange to be made in the future. Forward rates are quoted for various future dates (e.g., 30 days, 60 days, 90 days, or one year).

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Question ID: 413966

An analyst observes that the exchange rate for Mexican pesos is MXN/USD 8.0000, and the exchange rate for Polish zlotys is PLN/USD 6.0000. The MXN/PLN exchange rate is closest to:

- ✗ **A) 0.7500.**
- ✓ **B)** 1.3333.
- ✗ **C)** 14.0000.

Explanation

The cross rate of MXN/PLN is (MXN/USD 8) / (PLN/USD 6) = 1.3333 MXN/PLN.

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Question ID: 413962

If the exchange rate value of the CAD goes from USD 0.60 to USD 0.80, then the CAD:

- ✗ **A) depreciated and Canadians will find U.S. goods cheaper.**
- ✓ **B)** appreciated and Canadians will find U.S. goods cheaper.
- ✗ **C)** depreciated and Canadians will find U.S. goods more expensive.

Explanation

The CAD is now more expensive in terms of USD, and thus it has *appreciated*. Therefore, each CAD yields more USD than before, and Canadians are able to purchase more U.S. goods with each CAD, making U.S. goods relatively cheaper.

Question #6 of 104

Question ID: 434251

In 20X5, Carthage's merchandise imports exceeded the value of its merchandise exports. In this case, Carthage would *most likely* have which of the following?

- ✗ **A) Balance of trade surplus.**
- ✓ **B)** Capital account surplus.
- ✗ **C)** Current account surplus.

Explanation

If a country is running a current account deficit, it must have an inflow of foreign capital, creating a surplus in the capital account.

Question #7 of 104

Question ID: 445333

The *most* accurate description of the relative roles played by the International Monetary Fund, World Bank, and World Trade Organization is that the only one explicitly focused on:

- ✓ **A) reducing poverty is the World Bank.**

✗ **B)** expanding international trade is the World Trade Organization.

✗ **C)** providing funding to member nations is the International Monetary Fund.

Explanation

The World Bank has the explicit mission of fighting poverty. Both the WTO and IMF work to expand international trade. Both the World Bank and IMF provide funds to member nations, the World Bank for development and the IMF when member nations experience balance of payments difficulties.

Question #8 of 104

Question ID: 413954

Participants in foreign exchange markets that can be characterized as "real money accounts" *most likely* include:

✗ **A)** **central banks.**

✓ **B)** insurance companies.

✗ **C)** hedge funds.

Explanation

Real money accounts are foreign exchange buy-side investors that do not use derivatives. Many mutual funds, pension funds, and insurance companies can be classified as real money accounts. Hedge funds typically use derivatives. Central banks usually do not act as investors in foreign exchange markets but may intervene in foreign exchange markets to achieve monetary policy objectives.

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Question ID: 413974

The spot CHF/EUR exchange rate is 1.2025. If the 90-day forward quotation is +0.25%, the 90-day forward rate is *closest to*:

✗ **A)** **1.2000.**

✓ **B)** 1.2055.

✗ **C)** 1.2050.

Explanation

The 90-day forward CHF/EUR exchange rate is 1.2025 × 1.0025 = 1.20551. The EUR is at a forward premium to the CHF.

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Question ID: 413948

Other things equal, a real exchange rate (stated as units of domestic currency per unit of foreign currency) will decrease as a result of an increase in the:

✗ **A)** **nominal exchange rate (domestic/foreign).**

✗ **B)** foreign price level.

✓ **C)** domestic price level.

Explanation

An increase in the domestic price level, other things equal, will decrease a real exchange rate. Increases in the nominal exchange rate or the foreign price level, other things equal, will increase a real exchange rate.

Question #11 of 104

Question ID: 413925

Suppose the world price of Mercury tennis shoes is $60, but they sell in the U.S. for $75 due to a $15 import tariff. Who will *most likely* be negatively affected by the tariff?

✗ **A)** **Foreign consumers.**

✗ **B)** Producers.

✓ **C)** U.S. consumers.

Explanation

Tariffs benefit domestic producers of products because the level of imports will be reduced due to an effective increase in the price of the goods. Consumers in the country lose due to higher prices.

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Question ID: 413944

Holding other factors constant, a country can reduce its trade deficit by increasing its:

✗ **A)** **government budget deficit.**

✗ **B)** domestic capital investment.

✓ **C)** private saving.

Explanation

Other things equal, increasing savings would decrease a current account deficit, while increasing a government budget deficit or domestic investment would increase a current account deficit.

Question #13 of 104

Question ID: 413917

Which type of advantage determines the pattern of trade in the world?

✗ **A)** **Absolute advantage.**

✗ **B)** Advantages due to tariffs and quotas.

✓ **C)** Comparative advantage.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. According to the law of comparative advantage, trading partners are *both* better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for goods for which they are the high-opportunity cost producer.

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Question ID: 413914

The law of comparative advantage explains why a nation will benefit from trade when it:

✓ **A)** **exports goods for which it is a low-cost producer, while importing those for which it is a high-cost producer.**

✗ **B)** exports goods for which it is a high-cost producer, while importing those for which it is a low-cost producer.

✗ **C)** exports more than it imports.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. When trading partners specialize in producing products for which they have a comparative advantage; costs are minimized, output is greater, and both trading partners benefit.

Question #15 of 104

Question ID: 413928

The primary benefits derived from tariffs usually accrue to:

✗ **A)** **domestic producers of export goods.**

✓ **B)** domestic suppliers of goods protected by tariffs.

✗ **C)** foreign producers of goods protected by tariffs.

Explanation

Tariffs raise domestic prices, benefiting domestic suppliers.

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Question ID: 434255

In the balance of payments accounts, goods and financial assets that migrants bring to a country are included in the:

✓ **A)** **capital account.**

✗ **B)** financial account.

✗ **C)** current account.

Explanation

The capital account includes goods and financial assets that migrants bring when they come to a country or take with them when they leave.

Question #17 of 104

Question ID: 413965

Given the following quotes, GBP/USD 2.0000 and MXN/USD 8.0000, calculate the direct MXN/GBP spot cross exchange rate.

✗ **A) 0.2500.**

✗ **B)** 0.6250.

✓ **C)** 4.0000.

Explanation

Invert the first quote to read USD/GBP 0.5000. Then, 0.5000 × 8.0000 = 4.0000 MXN/GBP.

Question #18 of 104

Question ID: 413926

Who benefits *least* from tariffs?

✓ **A) Domestic consumers.**

✗ **B)** Domestic producers.

✗ **C)** Foreign consumers.

Explanation

A tax imposed on imports is called a tariff, which benefits domestic producers and domestic governments. Domestic consumers lose through higher prices, less choice of products, and lower quality products.

Question #19 of 104

Question ID: 472414

A government that imposes restrictions on capital flows into or out of the country is *most likely* attempting to:

✗ **A) increase domestic interest rates.**

✓ **B)** reduce the volatility of domestic asset prices.

✗ **C)** encourage competition in domestic industries.

Explanation

Reasons commonly cited by governments for imposing capital restrictions include reducing the volatility of domestic asset prices, maintaining control of exchange rates, keeping domestic interest rates low, and protecting strategic industries from foreign ownership.

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Question ID: 413960

The exchange rate for Japanese yen (JPY) per euro (EUR) changes from 98.00 to 103.00 JPY/EUR. How has the value of the EUR changed relative to the JPY in percentage terms?

✓ **A) Appreciated by 5.1%.**

✗ **B)** Appreciated by 4.9%.

✗ **C)** Depreciated by 4.9%.

Explanation

Because the exchange rates are quoted with the EUR as the base currency, the percentage change is simply 103.00 / 98.00 − 1 = 5.1%. The increase in the quoted JPY/EUR exchange rate means it now requires 5.1% more JPY to purchase one EUR. Thus, the EUR has appreciated by 5.1% against the JPY.

Question #21 of 104

Question ID: 413956

Which of the following would *least likely* be a participant in the forward market?

✗ **A)** **Traders.**

✓ **B)** Long-term investors.

✗ **C)** Arbitrageurs.

Explanation

Forward contracts are for 30, 90, 180, and 360-day periods and would, therefore, be considered short-term investment choices. Other participants in the forward market are hedgers who use forward contracts to protect the home currency value of foreign currency denominated assets on their balance sheets over the life of the contracts involved.

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Question ID: 485768

Two countries trade freely with each other and have agreed to specific tariffs on imports from other countries. The workers in either country may freely cross the common border to work in the other country. The two countries have agreed to common economic policies, but they use separate currencies. This type of cooperation is *best* described as a(n):

✓ **A)** **economic union.**

✗ **B)** customs union.

✗ **C)** monetary union.

Explanation

The two countries are a part of an economic union. In an economic union, there is (1) free trade among members, (2) common restrictions (tariffs) on imports from non-members, (3) free movement of production factors (labor), and (4) common economic institutions and coordination of economic policies. While a customs union has common tariffs on imports from non-union countries and free trade, it does not allow workers to cross the borders freely and does not have common economic institutions. A monetary union requires all of the listed items and a common currency.

Question #23 of 104

Question ID: 413968

If the spot exchange rate between the British pound and the U.S. dollar is GBP/USD 0.7775, and the spot exchange rate between the Canadian dollar and the British pound is CAD/GBP 1.8325, what is the USD/CAD spot cross exchange rate?

- ✓ **A)** **0.70186.**
- ✗ **B)** 0.42428.
- ✗ **C)** 1.42477.

Explanation

First, convert GBP/USD 0.7775 to 1/0.7775 = USD/GBP 1.28617.

Then, divide USD/GBP 1.28617 by CAD/GBP 1.8325 = USD/CAD 0.70187.

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Question ID: 413964

Given an exchange rate of USD/CAD 0.9250 and USD/CHF 1.6250, what is the cross rate for CAD/CHF?

- ✗ **A)** **1.5032.**
- ✓ **B)** 1.7568.
- ✗ **C)** 0.5692.

Explanation

(USD/CHF 1.6250) / (USD/CAD 0.9250) = CAD/CHF 1.7568

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Question ID: 413907

Which of the following statements about the costs and benefits of international trade is *most* accurate?

- ✓ **A)** **The costs of trade primarily affect those in domestic industries that compete with imports.**
- ✗ **B)** The costs of trade are greater than the benefits with regard to domestic employment.
- ✗ **C)** Increased international trade benefits all groups in the trading countries.

Explanation

The benefits of trade are greater than the costs for the overall economy, but those in domestic industries competing with imports may suffer costs in the form of reduced profits or employment.

Question #26 of 104

Question ID: 434252

The balance of payments accounts consist of:

- ✗ **A)** **capital account, financial account, and non-financial account.**
- ✗ **B)** current account, capital account, and currency account.
- ✓ **C)** current account, capital account, and financial account.

Explanation

According to the U.S. Federal Reserve, "The BOP [balance of payments] includes the current account, which mainly measures the flows of goods and services; the capital account, which consists of capital transfers and the acquisition and disposal of non- produced, non-financial assets; and the financial account, which records investment flows."

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Question ID: 413975

If the no-arbitrage forward exchange rate for a euro in Japanese yen is less than the spot rate, then the interest rate in:

- ✗ **A)** **the eurozone is less than in Japan.**
- ✓ **B)** Japan is less than in the eurozone.
- ✗ **C)** Japan is the same as in the eurozone.

Explanation

If the quote is in terms of JPY per EUR, this implies that the JPY is expected to appreciate relative to the EUR. There will be no arbitrage opportunity only if the interest rate in Japan is lower than the interest rate in the eurozone.

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Question ID: 413903

For a country that produces 100 million more income from foreign capital invested within the country than from domestic investment abroad, and produces 100 million more goods and services by foreign labor within the country than by its citizens abroad, gross national product is:

- ✗ **A)** **equal to gross domestic product.**
- ✗ **B)** greater than gross domestic product.
- ✓ **C)** less than gross domestic product.

Explanation

GNP measures output produced by a country's citizens and capital owned by its citizens. GDP measures output produced within a country. In this example, production within the country (GDP) is greater than production by the country's citizens (GNP).

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Question ID: 413938

The North American Free Trade Agreement (NAFTA) is *most accurately* described as a:

- ✗ **A)** **common market.**
- ✗ **B)** customs union.
- ✓ **C)** free trade area.

Explanation

NAFTA is a free trade area, in which the member nations remove barriers to imports and exports among themselves. In a customs union, all members adopt common trade policies with non-members. A common market goes further, removing all barriers to movement of labor and capital among members.

Question #30 of 104

Question ID: 413909

The table below outlines the possible tradeoffs of producing beer and cheese for Germany and Holland.

Germany		*Holland*	
Cheese	*Beer*	*Cheese*	*Beer*
0	10	0	6
5	0	4	0

Which of the following statements is *most* accurate?

✗ **A) Germany would not gain from trade, because it has an absolute advantage in the production of both goods.**

✗ **B)** Both countries would gain if Germany traded cheese for Holland's beer.

✓ **C)** Both countries would gain if Germany traded beer for Holland's cheese.

Explanation

Germany has an absolute advantage in both beer and cheese because it can produce more of both than Holland. The opportunity cost of producing beer is 5/10 = 0.5 in Germany and 4/6 = 0.67 in Holland. The opportunity cost of producing cheese is 10/5 = 2 in Germany and 6/4 = 1.5 in Holland. Holland has a comparative advantage in producing cheese and Germany has a comparative advantage in producing beer. Both countries gain if Germany trades beer for Holland's cheese.

Question #31 of 104

Question ID: 434266

The spot rate for Japanese yen per UK pound is 138.78. If the UK interest rate is 1.75% and the Japanese interest rate is 1.25%, the 6-month no-arbitrage forward rate is *closest to:*

✓ **A) 138.44 JPY/GBP.**

✗ **B)** 138.95 JPY/GBP.

✗ **C)** 138.10 JPY/GBP.

Explanation

The calculation is as follows:

$$F_{\frac{JPY}{GBP}} = S_{\frac{JPY}{GBP}} \times \frac{(1 + i_{Japan})}{(1 + i_{Great\ Britain})}$$

$$= 138.78 \times \frac{(1 + 0.0125 / 2)}{(1 + 0.0175 / 2)}$$

$$= 138.44$$

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Question ID: 413905

In contrast to gross domestic product (GDP), gross national product (GNP) includes income earned by:

- ✗ **A)** **foreign capital invested domestically.**
- ✗ **B)** foreign labor working domestically.
- ✓ **C)** domestic capital invested abroad.

Explanation

GNP includes goods and services produced outside the country by domestic factors of production, both labor and capital.

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Question ID: 413918

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	*Country B*
Food	9	5
Drink	7	5

Which of the following statements is *most* accurate?

- ✓ **A)** **Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.**
- ✗ **B)** Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.
- ✗ **C)** Since B workers can produce more of food and drink than A workers, no gains from trade are possible.

Explanation

Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production. The reason centers on comparative advantage. Country A must give up $7/9^{th}$ unit of drink to produce one unit of food. Country B must give up 1 unit of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for B than for A. If B produces 5 units of drink and A produces 9 units of food, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

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Question ID: 413943

In a country that has a current account surplus, it is *most likely* that:

- ✓ **A)** **domestic savings are greater than domestic investment.**
- ✗ **B)** domestic investment is greater than government savings.
- ✗ **C)** private domestic savings are greater than the budget deficit.

Explanation

The relationship between saving, investment, and the trade deficit can be expressed as:
(exports - imports) = private savings + government savings - investment

A country will have a current account surplus (exports > imports) if the sum of domestic private savings and government savings is greater than domestic investment, or a current account deficit (imports > exports) if the sum of domestic private savings and government savings is less than domestic investment.

Question #35 of 104

Question ID: 413957

Which of the following would least likely be a participant in the forward market?

✗ **A)** **Traders.**

✗ **B)** Arbitrageurs.

✓ **C)** Long-term investors.

Explanation

Forward contracts are for 30, 90, 180, and 360-day periods and would, therefore, be considered short-term investment choices. Other participants in the forward market are hedgers who use forward contracts to protect the home currency value of foreign currency denominated assets on their balance sheets over the life of the contracts involved.

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Question ID: 413937

The form of regional trading agreement (RTA) *least likely* to have the unintended negative effect of reducing a member country's low-cost imports from a non-member country is a:

✓ **A)** **free trade area.**

✗ **B)** customs union.

✗ **C)** common market.

Explanation

A free trade area removes barriers to trade among its members but does not require any of its members to change their trade policies with non-members. A common market and a customs union both impose uniformity on trade rules with non-member nations, which could restrict a member's low-cost imports from a nation that is not a member.

Question #37 of 104

Question ID: 413915

According to the law of comparative advantage:

✗ **A)** **if a foreign government subsidizes the textile industry, the domestic government should impose a tariff.**

✗ **B)** Mexico is considered to have a comparative advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.

✓ **C)** a nation will benefit from trade when it imports goods for which it is the high cost producer and exports goods for which it is the low-cost producer.

Explanation

This statement is the law of comparative advantage.

The other choices are incorrect. The law of comparative advantage supports international trade. According to the law of comparative advantage, both trading partners are better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for those goods for which they are the high-opportunity cost producer. Mexico is considered to have *an absolute* advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.

Question #38 of 104

Question ID: 413919

In the Heckscher-Ohlin model, whether a country has a comparative advantage relative to another country is determined by:

✓ **A)** **amounts of labor and capital the countries possess.**

✗ **B)** labor productivity differences.

✗ **C)** capital productivity differences.

Explanation

In the Heckscher-Ohlin model a country that has relatively more capital will export capital-intensive goods and import labor-intensive goods, while a country that has relatively more labor will export labor-intensive goods and import capital-intensive goods.

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Question ID: 434247

Compared to not engaging in international trade, a country that engages in international trade is *most likely* to experience:

✗ **A)** **higher prices for consumer goods.**

✓ **B)** increased specialization of domestic industries.

✗ **C)** lower employment in exporting industries.

Explanation

International trade should result in greater specialization in domestic industries because production shifts to lines in which domestic producers have a comparative advantage.

Question #40 of 104

Question ID: 413933

Prior to the beginning of summer, the government of Japan places a 150 percent tariff on imported chain saws. Assume for this example that this tariff has a significant impact on the supply of chain saws. The government's action:

✗ **A)** **will protect the jobs and high wages of Japanese chain saw industry workers.**

✗ **B)** is more harmful than if the government had limited the amount of chain saws imported.

✓ **C)** benefits the Japanese government and domestic producers.

Explanation

The Japanese government's action is an example of a *tariff*. A tariff is a tax imposed on imports and benefits the Japanese government because it collects the tariff. Domestic producers benefit because the reduction in the supply of imported goods means a higher domestic price.

The other choices are incorrect. A tariff is considered *less* harmful than a quota (an import quantity limitation) because under a quota, the domestic government does *not* receive any funds as it would under a tariff (the foreign producers receive the revenue transfer). In the long run, trade restrictions do not protect the net number of jobs in the country. The number of jobs protected by import restrictions will be offset by jobs lost in the import/export industry. Import/export firms will be unable to sell the overpriced domestic products abroad or import and sell the lower priced restricted foreign-made product.

Question #41 of 104

Question ID: 434253

Capital transfers and sales of non-financial assets are included in which of the balance of payments accounts?

✓ **A) Capital account.**

✗ **B)** Financial account.

✗ **C)** Current account.

Explanation

Capital transfers and sales of non-financial assets are sub-accounts of the capital account.

Question #42 of 104

Question ID: 413989

The Marshall-Lerner condition suggests that a country's ability to narrow a trade deficit by devaluing its currency depends on:

✗ **A) capacity utilization in the domestic economy.**

✗ **B)** national saving relative to domestic investment.

✓ **C)** elasticity of demand for imports and exports.

Explanation

The Marshall-Lerner condition is an outcome of the elasticities approach to analyzing the balance of trade. It suggests that depreciation or devaluation of a currency is more likely to narrow a country's trade deficit if domestic demand for imports and foreign demand for the country's exports are more elastic. The absorption approach to analyzing the balance of trade implies that national saving must increase relative to domestic investment for a currency devaluation to narrow a trade deficit, which in turn depends on whether the economy is producing at maximum capacity (full employment or potential GDP) when the devaluation occurs.

Question #43 of 104

Question ID: 413980

The USD/EUR spot exchange rate is 1.3500 and 6-month forward points are −75. The 6-month forward exchange rate is:

✗ **A) 1.3425, and the USD is at a forward discount.**

✓ **B)** 1.3425, and the USD is at a forward premium.

✗ **C)** 1.3575, and the USD is at a forward discount.

Explanation

For an exchange rate quoted to four decimal places, each forward point represents 0.0001. The 6-month forward exchange rate is 1.3500 − 0.0075 = 1.3425 USD/EUR. The USD is expected to appreciate against the EUR and is trading at a forward premium.

Question #44 of 104

Question ID: 434250

The most integrated type of trading bloc or regional trade agreement is a(n):

✗ **A) economic union.**

✓ **B)** monetary union.

✗ **C)** common market.

Explanation

A monetary union, such as the European Union, is the most integrated type of trading bloc or regional trade agreement because the members adopt a common currency.

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Question ID: 413924

An anti-dumping restriction on trade:

✗ **A) protects infant industries.**

✗ **B)** keeps some highly sensitive products in the country.

✓ **C)** prohibits foreign firms from selling products below cost to gain market share.

Explanation

Firms dump their goods at a price lower than cost in order to drive out the competition. Once this is complete, they will be able to raise prices to much higher levels in order to gain abnormal profits. Of course, once prices are increased, new competitors may arise.

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Question ID: 413906

Country P imports goods from Country Q. In the long run, the benefits of international trade *most likely* accrue to:

✗ **A) Country P only.**

✓ **B)** Both Country P and Country Q.

✗ **C)** Country Q only.

Explanation

The overall benefits of international trade are greater than the costs for the global economy as a whole. All countries should benefit in the long run as costs of international trade are mostly short run effects.

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Question ID: 413969

The Japanese yen is trading at JPY/USD 115.2200 and the Danish krone (DKK) is trading at JPY/DKK 16.4989. The USD/DKK exchange rate is:

✗ **A)** **6.9835.**

✗ **B)** 0.5260.

✓ **C)** 0.1432.

Explanation

The cross rate between USD and DKK is calculated in the following manner:

> (USD/JPY)(JPY/DKK) = (1 / 115.2200) × 16.4989 = USD/DKK 0.1432 (the Yen cancels out)

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Question ID: 413920

The source of comparative advantage in the Heckscher-Ohlin model of trade is differences among countries in:

✗ **A)** **technological advancement.**

✓ **B)** relative scarcity of labor and capital.

✗ **C)** labor productivity.

Explanation

In the Heckscher-Ohlin model of trade, the source of comparative advantage is the relative scarcity of labor and capital in each country.

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Question ID: 413970

The spot exchange rate for CHF/EUR is 0.8342 and the 1-year forward quotation is −0.353%. The 1-year forward exchange rate for EUR/CHF is *closest to*:

✓ **A)** **1.2029.**

✗ **B)** 1.2022.

✗ **C)** 0.8313.

Explanation

The forward rate for CHF/EUR is 0.8342 × (1 − 0.00353) = 0.8313. The 1-year forward EUR/CHF exchange rate is 1 / 0.8313

= 1.2030.

Question #50 of 104

Question ID: 413934

Regional trade agreements exist primarily to:

✗ **A)** **lower currency volatility for their members.**

✗ **B)** protect their members from unfair trading practices by non-members.

✓ **C)** improve economic welfare for their members.

Explanation

The primary reason countries join regional trade agreements is to improve economic welfare by reducing or eliminating trade restrictions.

Question #51 of 104

Question ID: 413952

An exchange rate at which two parties agree to trade a specific amount of one currency for another a year from today is called a:

✗ **A)** **real exchange rate.**

✓ **B)** forward exchange rate.

✗ **C)** spot exchange rate.

Explanation

A forward exchange rate specifies the amount of two currencies that will be exchanged at a specific point of time in the future. A transaction that uses the spot exchange rate is one that would occur immediately. A real exchange rate is one that has been adjusted for the relative inflation rates in two countries, and could be referring to an exchange rate that prevails at any given time.

Question #52 of 104

Question ID: 413930

Which of the following arguments in favor of trade restrictions is *least likely* to be supported by economists?

✗ **A)** **Infant industries should be protected.**

✗ **B)** National defense industries should be protected.

✓ **C)** Trade with low-wage countries depresses wage rates in high-wage countries.

Explanation

Trade with low-wage countries does not in itself depress wage rates since productivity must be considered. The other arguments have some support among economists.

Question #53 of 104

Question ID: 413982

Currency depreciation is *most likely* to affect the balance of trade when a country's imports are goods that:

✓ **A) have close substitutes.**

✗ **B)** represent a small proportion of consumer spending.

✗ **C)** have relatively inelastic demand.

Explanation

According to the elasticities approach, the more elastic the demand for imports or exports, the greater the effect on the balance of trade from currency depreciation. Demand is more elastic for imports or exports when they are primarily goods with close substitutes, luxury goods, or goods that represent a large proportion of a consumer's spending.

Question #54 of 104

Question ID: 434259

Ensuring that international trade flows smoothly and freely, settling trade disputes, and establishing agreements between trading partners *most accurately* describe the activities of the:

✗ **A) International Monetary Fund.**

✓ **B)** World Trade Organization.

✗ **C)** World Bank.

Explanation

The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible.

Question #55 of 104

Question ID: 434264

If the current spot exchange rate for quotes of JPY/GBP is greater than the no-arbitrage 3-month forward exchange rate, the 3-month GBP interest rate is:

✗ **A) less than the 3-month JPY interest rate.**

✓ **B)** greater than the 3-month JPY interest rate.

✗ **C)** equal to the 3-month JPY interest rate.

Explanation

$\frac{\text{forward}_{JPY/GBP}}{\text{spot}_{JPY/GBP}} = \frac{(1 + \text{interest rate}_{JPY})}{(1 + \text{interest rate}_{GBP})}$. If the no-arbitrage forward JPY/GBP rate is less than the spot rate, the interest rate for JPY must be less than the interest rate for GBP.

Question #56 of 104

Question ID: 441026

The spot exchange rate for Canadian dollars (CAD) per Swiss franc (CHF) is 1.1350 CAD/CHF and the 12-month forward exchange rate is 1.1460 CAD/CHF. The forward quote is a:

✓ **A) premium of 110 points and the CAD is at a forward discount to the CHF.**

✗ **B)** premium of 11 points and the CAD is at a forward premium to the CHF.

✗ **C)** discount of 110 points and the CAD is at a forward discount to the CHF.

Explanation

Because the forward CAD/CHF exchange rate is higher than the spot rate, the quote is a forward premium. Forward points represent 0.0001 for an exchange rate quoted to four decimal places. Here, the forward discount is 1460 − 1350 = 110 points. The base currency, the CHF, is at a forward premium to the CAD, therefore the CAD is at a forward discount to the CHF.

Question #57 of 104

Question ID: 413910

The table below outlines the possible tradeoffs of producing units of cloth and corn for both Country A and Country B.

Country A		*Country B*	
Units of Cloth	*Units of Corn*	*Units of Cloth*	*Units of Corn*
0	4	0	8
6	3	8	6
14	0	16	0

Which scenario *best* describes the effects of trade between the countries?

✓ **A) Both countries would gain if Country A traded cloth for Country B's corn.**

✗ **B)** Both countries would gain if Country A traded corn for Country B's cloth.

✗ **C)** Country B would not gain from trade, because it has an absolute advantage in the production of both goods.

Explanation

If Country B devotes all of its resources to producing corn, it will make 8 units while, under the same circumstances, Country A will make 4 units. Therefore, Country B is twice as productive with respect to corn as Country A. Country B can also produce more cloth (16 units) in relation to Country A (14 units) supposing all resources are used for cloth. However, rather than being twice as productive as was the case for corn, it is only slightly more productive. Therefore, Country B has a comparative advantage in corn, and thus should specialize in its production, while Country A should specialize in the production of cloth.

Question #58 of 104

Question ID: 413945

The primary goals of the International Monetary Fund (IMF) include:

✗ **A) reducing global poverty.**

✓ **B)** promoting exchange rate stability.

✗ **C)** resolving trade-related disputes among nations.

Explanation

The primary goals of the IMF are to promote international monetary cooperation, facilitate growth of international trade, promote exchange rate stability, assist in establishing a multilateral payment system, and provide resources to members with balance of payments difficulties. Reducing global poverty is a role of the World Bank. Resolving trade disputes is a role of the World Trade Organization.

Question #59 of 104

Question ID: 434257

Government-owned assets abroad and foreign-owned assets in the country are included in which of the balance of payments accounts?

✗ **A)** **Capital account.**

✓ **B)** Financial account.

✗ **C)** Current account.

Explanation

Government-owned assets abroad and foreign-owned assets in the country are sub-accounts of the financial account.

Question #60 of 104

Question ID: 413985

In which of the following exchange rate regimes can a country participate without giving up its own currency?

✗ **A)** **Monetary union or currency board.**

✓ **B)** Target zone or conventional fixed peg.

✗ **C)** Crawling peg or formal dollarization.

Explanation

With formal dollarization or a monetary union, a country does not have its own currency. With a currency board, conventional fixed peg, target zone, or crawling peg, a country has its own currency and manages its exchange rate with another currency or basket of currencies.

Question #61 of 104

Question ID: 413949

If we compare the prices of goods in two countries through time, we can use the price information in concert with the quoted foreign exchange rate to calculate the:

✗ **A)** **interest rate spread.**

✗ **B)** nominal exchange rate.

✓ **C)** real exchange rate.

Explanation

A comparison of consumption costs between two markets can, in concert with the foreign exchange rate (also called the nominal exchange rate), be used to calculate the real exchange rate.

Question #62 of 104

Question ID: 413979

Spot and one-month forward exchange rates are as follows:

	Spot	*1-month forward*
EUR/DEF	2.5675	2.5925
EUR/GHI	4.3250	4.2800
EUR/JKL	7.0625	7.0075

Based on these exchange rates, the EUR is *closest* to a 1-month forward:

✓ **A) premium of 1% to the GHI.**

✗ **B)** discount of 1% to the JKL.

✗ **C)** premium of 1% to the DEF.

Explanation

The EUR is at a forward premium to the GHI because the EUR/GHI forward rate is less than the EUR/GHI spot rate. The base currency, GHI, is at a forward discount of forward/spot - 1 = 4.2800 / 4.3250 - 1 = -1.04%. The EUR is at a forward discount to the DEF and a forward premium to the JKL.

Question #63 of 104

Question ID: 434246

The income from a country's citizens working abroad is included in:

✓ **A) gross national product, but not gross domestic product.**

✗ **B)** gross domestic product, but not gross national product.

✗ **C)** both gross domestic product and gross national product.

Explanation

Gross domestic product includes the total value of goods and services produced within a country's borders. The income of a country's citizens working abroad is included in its GNP but not in its GDP.

Question #64 of 104

Question ID: 434265

Country G and Country H have currencies that trade freely and have markets for forward currency contracts. If Country G has an interest rate greater than that of Country H, the no-arbitrage forward G/H exchange rate is:

✓ **A) greater than the G/H spot rate.**

✗ **B)** equal to the G/H spot rate.

✗ **C)** less than the G/H spot rate.

Explanation

$\frac{\text{forward}}{\text{spot}} = \frac{(1 + \text{interest rate}_{\text{Country G}})}{(1 + \text{interest rate}_{\text{Country H}})}$. If the interest rate in Country G is greater than the interest rate in Country H, the numerator is greater than the denominator on the right side of the equation. The left side must have the same relationship, so the forward rate must be greater than the spot rate.

Question #65 of 104

Question ID: 413939

In the context of international trading blocs, the primary feature of an economic union that distinguishes it from a common market is the adoption of a common:

- ✓ **A) set of economic policies.**
- ✗ **B)** currency.
- ✗ **C)** set of trade restrictions with non-members.

Explanation

An economic union is a common market that has also adopted common institutions and economic policy. Both common markets and economic unions adopt a common set of trade restrictions with non-members. Neither requires the adoption of a common currency, which is a characteristic of a monetary union.

Question #66 of 104

Question ID: 413904

An analyst is interested in measuring the economic activity within one nation. The *most appropriate* measure to use is:

- ✗ **A) gross national product.**
- ✓ **B)** gross domestic product.
- ✗ **C)** national income.

Explanation

Gross domestic product measures output produced within a country, regardless of where the factors of production come from. Gross national product includes output produced by citizens working abroad, and does not include output produced domestically by foreigners. GDP accounts for the need to replace physical capital as it wears out; national income does not.

Question #67 of 104

Question ID: 413955

The sell side of the foreign exchange markets primarily consists of:

- ✗ **A) retail investors.**
- ✓ **B)** multinational banks.
- ✗ **C)** accounting firms.

Explanation

The sell side of foreign exchange markets is primarily large multinational banks. They are the primary dealers in currencies and originators of forward foreign exchange contracts.

Question #68 of 104

Question ID: 413942

Other things equal, a current account deficit will tend to narrow if:

- ✗ **A) private savings decrease.**
- ✓ **B)** domestic investment decreases.
- ✗ **C)** taxes decrease.

Explanation

The relation between the trade deficit (the current account), savings (both private and government) and domestic investments is stated as (X - M) = private savings + government savings - investment. A current account deficit will tend to narrow if private savings increase, government savings increase (either taxes increase or government spending decreases), or domestic investment decreases.

Question #69 of 104

Question ID: 413927

David Forsythe and Linda Novak are discussing the advantages and disadvantages of import restrictions. They state the following:

> Forsythe: One of the groups that benefits from import restrictions is often the government that imposes them.
> Novak: Import restrictions impose costs on specific groups, such as the country's import industries, but these costs are more than offset by the benefits to other groups and to the economy as a whole.

With respect to these statements:

- ✓ **A) only one is correct.**
- ✗ **B)** both are correct.
- ✗ **C)** both are incorrect.

Explanation

Forsythe is correct. A primary reason why trade restrictions remain widespread is the revenue that governments receive from tariffs. Novak is incorrect. Trade restrictions benefit specific groups, such as workers in the protected industries, but those benefits are most often less than the costs imposed on consumers and other industries as a whole.

Question #70 of 104

Question ID: 413972

The spot exchange rate is 1.1132 GBP/EUR and the 1-year forward rate is quoted as +1349 points. The 1-year forward exchange rate for GBP/EUR is *closest to*:

- ✓ **A) 1.2481.**
- ✗ **B)** 1.2634.
- ✗ **C)** 1.1267.

Explanation

The one year forward is 1.1132 + (1349/10,000) = 1.2481.

Question #71 of 104

Question ID: 413923

Which of the items below is NOT a valid reason why nations adopt trade restrictions? To:

✓ **A) protect industries in which they have a comparative advantage.**

✗ **B)** protect industries that are highly sensitive to national security.

✗ **C)** prohibit foreign firms from increasing market share by selling products below cost.

Explanation

If a particular country enjoys a comparative advantage in a particular industry, no protection is needed.

Question #72 of 104

Question ID: 434260

Assuming no changes in the prices of a representative consumption basket in two currency areas over the measurement period, changes in the nominal exchange rate:

✗ **A) can be extrapolated to calculate interest rates.**

✓ **B)** are equal to changes in the real exchange rate.

✗ **C)** can be converted to the real exchange rate using interest rates.

Explanation

The real interest rate = the nominal interest rate × ratio of consumption basket (or index) price levels in both countries. Assuming no price changes, the real exchange rate has remained the same as the nominal interest rate during the period.

You can think of the ratio of the consumption basket (or index) price levels in two countries as the bracketed portion of the Fisher relation for two countries. Here is the Fisher relation for two countries:

$$\frac{(1 + R_{\text{nominal A}})}{(1 + R_{\text{nominal B}})} = \frac{(1 + R_{\text{real A}})[1 + E(\text{inflation}_A)]}{(1 + R_{\text{real B}})[1 + E(\text{inflation}_B)]}$$

Here is the ratio of the consumption basket (or index) price levels in two countries:

$$\frac{[1 + E(\text{inflation}_A)]}{[1 + E(\text{inflation}_B)]}$$

If inflation in A is 10% and inflation in B is 0%, the ratio of consumption basket (or index) price levels is 1.1. If inflation in both countries is 0%, the ratio of consumption basket (or index) price levels is 1 and the nominal interest rate = the real interest rate. If the nominal interest rate = the real interest rate, changes in the nominal exchange rate = changes in the real exchange rate.

Question #73 of 104

Question ID: 413967

If the CAD is trading at USD/CAD 0.6403 and the GBP is trading CAD/GBP 2.5207, the USD/GBP exchange rate is:

✗ **A)** **0.6196.**

✗ **B)** 3.9367.

✓ **C)** 1.6140.

Explanation

USD/CAD 0.643 × CAD/GBP 2.5207 = USD/GBP 1.6140.

Question #74 of 104

Question ID: 413932

Who benefits the *most* from a quota?

✓ **A)** **Domestic producers.**

✗ **B)** Foreign consumers.

✗ **C)** Foreign producers.

Explanation

Quotas restrict the supply of imported goods, which increases the price domestically benefiting domestic producers. Some foreign producers also benefit from the higher prices created by the quota if they receive the revenue transfer (due to higher prices received for all goods sold under the import license). However, overall the foreign producers do not sell as much of their product and have lost revenues.

Question #75 of 104

Question ID: 413958

The exchange rate for Chinese yuan (CNY) per euro (EUR) changed from CNY/EUR 8.1588 to CNY/EUR 8.3378 over a 3-month period. It is *most accurate* to state that the:

✗ **A)** **EUR has appreciated 2.15% relative to the CNY**

✓ **B)** EUR has appreciated 2.19% relative to the CNY.

✗ **C)** CNY has depreciated 2.19% relative to the EUR.

Explanation

The percentage change in the CNY value of one EUR is (8.3378 / 8.1588) - 1 = 0.0219. The EUR has appreciated 2.19% relative to the CNY. This is not the same as CNY depreciating by 2.19% relative to the EUR. The percentage change in the CNY is [(1 / 8.3378) / (1 / 8.1588)] - 1 = -0.0215 = -2.15%.

Question #76 of 104

Question ID: 434254

Merchandise and services, income receipts, and unilateral transfers are included in which of the balance of payments accounts?

✗ **A)** **Capital account.**

✓ **B)** Current account.

✗ **C)** Financial account.

Explanation

Merchandise and services, income receipts, and unilateral transfers are sub-accounts of the current account.

Question #77 of 104

Question ID: 413935

Which form of regional trading agreement is *least likely* to allow free movement of labor?

✗ **A)** **Economic union.**

✗ **B)** Common market.

✓ **C)** Customs union.

Explanation

Economic unions and common markets remove all barriers to the movement of labor and capital among their members. Customs unions do not have this feature.

Question #78 of 104

Question ID: 413916

A country has a comparative advantage over another when:

✗ **A)** **a nation can produce more output with a given amount of input than another nation.**

✗ **B)** it can produce a product with the fewest resources.

✓ **C)** a nation has the ability to produce a good with a lower opportunity cost than another nation.

Explanation

A nation will have a comparative advantage in the production of good A when the number of units of B, given up to produce one unit of A, is lower than that for any other country.

Question #79 of 104

Question ID: 413940

Sales and purchases of non-produced, non-financial assets are included in which of a country's trade accounts?

✓ **A)** **Capital account.**

✗ **B)** Financial account.

✗ **C)** Current account.

Explanation

The capital account consists of sales and purchases of non-produced, non-financial assets plus capital transfers.

Question #80 of 104

Question ID: 413912

Suppose labor in Venezuela is less productive than labor in the United States in all areas of production. Which of the following statements about trading between Venezuela and the U.S. is *most* accurate?

✗ **A) Venezuela will not have a comparative advantage in any good.**

✓ **B)** Both nations can benefit from trade.

✗ **C)** Venezuela can benefit from trade but the U.S. cannot.

Explanation

Although one country may have an absolute advantage in all areas, trade is based on differences in opportunity costs, or comparative advantage. Any country will always have a comparative advantage in the production of some goods; thus, all countries can benefit from trade.

Question #81 of 104

Question ID: 413973

If the AUD/CAD spot exchange rate is 0.9875 and 60-day forward points are −25, the 60-day AUD/CAD forward rate is *closest to*:

✓ **A) 0.9850.**

✗ **B)** 0.9900.

✗ **C)** 0.9870.

Explanation

For an exchange rate quoted to four decimal places, forward points are expressed in units of 0.0001. The 60-day forward rate is $0.9875 + 0.0001(-25) = 0.9850$.

Question #82 of 104

Question ID: 413951

In the currency market, traders quote the:

✗ **A) base currency rate.**

✗ **B)** real exchange rate.

✓ **C)** nominal exchange rate.

Explanation

The nominal exchange rate is quite simply the price of one currency relative to another. It is the quote observed in currency markets.

Question #83 of 104

Question ID: 413984

The spot exchange rate for United States dollars per United Kingdom pound (USD/GBP) is 1.5775. If 30-day interest rates are 1.5% in the United States and 2.5% in the United Kingdom, and interest rate parity holds, the 30-day forward USD/GBP exchange rate should be:

- ✗ **A)** **1.5621.**
- ✗ **B)** 1.5788.
- ✓ **C)** 1.5762.

Explanation

Forward USD/GBP = spot USD/GBP × (1 + U.S. interest rate) / (1 + UK interest rate)
= 1.5775 × [(1 + 0.015/12) / (1 + 0.025/12)]
= 1.5762

Question #84 of 104

Question ID: 413959

The exchange rate for Australian dollars per British pound (AUD/GBP) was 1.4800 five years ago and is 1.6300 today. The percent change in the Australian dollar relative to the British pound is *closest to*:

- ✓ **A)** **depreciation of 9.2%.**
- ✗ **B)** depreciation of 10.1%.
- ✗ **C)** appreciation of 10.1%.

Explanation

To correctly calculate the percentage change in AUD relative to GBP, convert the exchange rates so that AUD is the base currency: 1 / 1.4800 = 0.6757 GBP/AUD five years ago and 1 / 1.6300 = 0.6135 GBP/AUD today. The percentage change in the Australian dollar against the British pound is 0.6135 / 0.6757 − 1 = −9.2%.

Note that the GBP has appreciated against the AUD by 1.6300 / 1.4800 − 1 = 10.1% over the same period.

Question #85 of 104

Question ID: 413921

In the Ricardian model of trade, the source of comparative advantage is:

- ✗ **A)** **capital productivity.**
- ✓ **B)** labor productivity.
- ✗ **C)** the difference between labor productivity and capital productivity.

Explanation

The Ricardian model of trade only considers labor as a factor of production. Comparative advantage results from differences in labor productivity. Labor and capital inputs are both considered in the Heckscher-Ohlin model of trade.

Question #86 of 104

Question ID: 434249

If a country can produce a good at a lower opportunity cost relative to another country, it is said to have a(n):

- ✗ A) **absolute advantage.**
- ✗ B) autarkian advantage.
- ✓ C) comparative advantage.

Explanation

A country is said to have a comparative advantage in the production of a good if its opportunity cost, in terms of other goods that could be produced instead, is lower than that of another country.

Question #87 of 104

Question ID: 413911

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	*Country B*
Food	4	8
Drink	6	7

Which of the following statements about the chart is *most* accurate?

- ✗ A) **Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.**
- ✓ B) Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.
- ✗ C) Since B workers can produce more of food and drink than A workers, no gains from trade are possible.

Explanation

Mutual gains could be realized from trade if A specialized in drink production and B specialized in food production. The reason centers on comparative advantage. Country A must give up 1.5 units of drink to produce one unit of food. Country B must give up 0.875 units of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for A than for B. If B produces 8 units of food and A produces 6 units of drink, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

Question #88 of 104

Question ID: 413963

The exchange rate of the Athelstan riyal (ATH) with the British pound is 9.00 ATH/GBP. The exchange rate of the Mordred ducat (MOR) with the U.S. dollar is 2.00 MOR/USD. If the USD/GBP exchange rate is 1.50, the ATH/MOR cross rate is *closest to*:

- ✗ A) **6.75 ATH/MOR.**

✓ **B)** 3.00 ATH/MOR.

✗ **C)** 12.00 ATH/MOR.

Explanation

The ATH/MOR cross rate = 9.00 ATH/GBP × (1 / 1.50) GBP/USD × (1 / 2.00) USD/MOR = 3.00 ATH/MOR.

Question #89 of 104

Question ID: 434256

A country that has imports valued more than its exports is said to have a:

✓ **A)** **current account deficit.**

✗ **B)** current account surplus.

✗ **C)** capital account deficit.

Explanation

A country that has imports valued more than its exports is said to have a current account (trade) deficit, while countries with more exports than imports are said to have a current account surplus.

Question #90 of 104

Question ID: 413908

This table below outlines the possible tradeoffs of producing milk and bread for Country A and Country B, in units of each product.

Country A		*Country B*	
Milk	*Bread*	*Milk*	*Bread*
0	5	0	8
10	0	12	0

Given these possible units of production:

✗ **A)** **neither country would gain from trade.**

✓ **B)** both countries would gain if Country A traded milk for B's bread.

✗ **C)** both countries would gain if Country A traded bread for B's milk.

Explanation

Country A gives up 1 bread to produce 2 milk. Country B gives up 1 bread to produce 1.5 milk. Country A should make milk and Country B should make bread.

Question #91 of 104

Question ID: 434248

Costs of international trade are *most likely* borne by:

✗ **A)** **consumers who pay higher prices for consumer goods.**

✓ **B)** industries competing with imported goods.

✗ **C)** consumers who have fewer choices of goods.

Explanation

Industries competing with imported goods may experience lower profit and employment due to international trade.

Question #92 of 104

Question ID: 413922

In the context of foreign trade, quotas are *best* described as:

✓ **A)** **limits on the amounts of imports a country allows over some period.**

✗ **B)** taxes on imported goods collected by the government.

✗ **C)** government payments to firms that export goods.

Explanation

Quotas are limits on the amounts of imports allowed into a country in a period of time. Government payments to firms that export goods are known as export subsidies. Taxes on imported goods collected by the government are known as tariffs.

Question #93 of 104

Question ID: 413946

The international organization whose primary role is settling disputes among trading nations is the:

✗ **A)** **World Bank.**

✓ **B)** World Trade Organization.

✗ **C)** International Monetary Fund.

Explanation

The role of the World Trade Organization is to deal with rules of global trade and settle trade-related disputes among nations.

Question #94 of 104

Question ID: 413961

If the exchange rate value of the CAD goes from USD 0.60 to USD 0.80, then the CAD:

✓ **A)** **appreciated and Canadians will find U.S. goods cheaper.**

✗ **B)** depreciated and Canadians will find U.S. goods more expensive.

✗ **C)** depreciated and Canadians will find U.S. goods cheaper.

Explanation

The CAD is now more expensive in terms of USD, and thus it has *appreciated*. Therefore, each CAD yields more USD than before, and Canadians are able to purchase more U.S. goods with each CAD, making U.S. goods relatively cheaper.

Question #95 of 104

Question ID: 413987

A country's central bank announces a monetary policy goal of a stable exchange rate with the euro, which it defines as deviations of no more than 3% from its current exchange rate of 2.5000. The country's exchange rate regime is *best* described as a:

✗ **A)** **crawling band.**

✓ **B)** target zone.

✗ **C)** fixed peg.

Explanation

This exchange rate regime is best described as a target zone, or a system of pegged exchange rates within horizontal bands. A target zone allows wider exchange rate fluctuations than a conventional fixed peg arrangement, which typically limits the permitted range to within 1% of the pegged exchange rate. Management of exchange rates within crawling bands allows the percentage deviation from the pegged exchange rate to increase over time.

Question #96 of 104

Question ID: 434263

In the foreign exchange markets, transactions by households and small institutions for tourism, cross-border investment, or speculative trading comprise the:

✗ **A)** **sovereign wealth market.**

✗ **B)** real money market.

✓ **C)** retail market.

Explanation

The retail foreign exchange market refers to transactions by households and relatively small institutions and may be for tourism, cross-border investment, or speculative trading.

Question #97 of 104

Question ID: 413971

The spot exchange rate is 0.6243 USD/GBP and the 1-year forward rate is quoted as 3.016%. The 1-year forward exchange rate for USD/GBP is *closest to*:

✗ **A)** **0.6054.**

✓ **B)** 0.6431.

✗ **C)** 0.6544.

Explanation

The one year forward rate is 0.6243 × (1 + 0.03016) = 0.6431.

Question #98 of 104

Question ID: 434267

The spot rate for Chinese yuan per Canadian dollar is 6.4440. If the Canadian interest rate is 2.50% and the Chinese interest rate is 3.00%, the 3-month no-arbitrage forward rate is *closest to:*

- ✗ **A) 6.475 CNY/CAD.**
- ✗ **B)** 6.436 CNY/CAD.
- ✓ **C)** 6.452 CNY/CAD.

Explanation

The calculation is as follows:

$$F_{\frac{CNY}{CAD}} = S_{\frac{CNY}{CAD}} \times \frac{(1+i_{China})}{(1+i_{Canada})}$$

$$= 6.444 \times \frac{(1+0.030/4)}{(1+0.025/4)}$$

$$= 6.452$$

Question #99 of 104

Question ID: 413931

In what way does a tariff differ from a quota? A tariff is:

- ✗ **A) not significantly different from a quota; tariffs are imposed by world organizations, whereas quotas are imposed by individual countries.**
- ✓ **B)** a tax imposed on imports, whereas a quota is a limit on the number of units of a good that can be imported.
- ✗ **C)** a tax imposed by a foreign government, whereas a quota is a limit on the total amount of trade allowed.

Explanation

The difference between a tariff and a quota is that a *tariff* is a tax imposed on imported goods, while a *quota* is an import quantity limitation. Also, a tariff will generate tax revenue, but a quota does not.

Question #100 of 104

Question ID: 413988

The tendency for currency depreciation to increase a country's trade deficit in the short run is known as the:

- ✓ **A) J-curve effect.**
- ✗ **B)** absorption effect.
- ✗ **C)** Marshall-Lerner effect.

Explanation

The J-curve refers to a graph of the effect of currency depreciation on the trade balance over time. In the short run, a trade deficit may increase because current import and export contracts may be fixed in foreign currency units over the near term, and only reflect the exchange rate change over time. In the long run, currency depreciation should decrease a trade deficit.

Question #101 of 104

Question ID: 413913

The law of comparative advantage holds that trading partners can be made better off if they:

✓ **A) specialize in production of goods for which they are the low opportunity cost producer.**

✗ **B)** specialize in production of goods for which they are the low exchange rate adjusted producer.

✗ **C)** import those goods for which they have a comparative advantage.

Explanation

The law of comparative advantage holds that trading partners can be made better off if they specialize in production of goods for which they are the low opportunity cost producer. They should export, not import, goods for which they have a comparative advantage. Absolute and exchange rate adjusted costs are not relevant to the concept of comparative advantage.

Question #102 of 104

Question ID: 434258

Promoting international monetary cooperation, promoting exchange stability, and assisting members experiencing balance of payments difficulties are the goals of the:

✓ **A) International Monetary Fund.**

✗ **B)** World Trade Organization.

✗ **C)** World Bank.

Explanation

The IMF's main goals are promoting international monetary cooperation; facilitating the expansion and balanced growth of international trade; promoting exchange stability; assisting in the establishment of a multilateral system of payments; and making resources available (with adequate safeguards) to members.

Question #103 of 104

Question ID: 434261

The difference between Country D's nominal and real exchange rates with Country F is *most* closely related to:

✗ **A) the risk-free interest rates of the two countries.**

✗ **B)** Country D's inflation rate.

✓ **C)** the ratio of the two countries' price levels.

Explanation

The difference between real exchange rates and nominal exchange rates is the relative inflation rates over time between the two countries. Real exchange rate (D/F) = nominal exchange rate (D/F) × $\frac{CPI_F}{CPI_D}$.

Question #104 of 104

Question ID: 413986

With respect to exchange rate regimes, crawling bands are *most likely* used in a transition toward:

✗ **A)** **a monetary union.**

✓ **B)** floating exchange rates.

✗ **C)** a fixed peg arrangement.

Explanation

When exchange rates are managed within crawling bands, the margin around a target exchange rate increases over time. This technique is sometimes used in a transition from fixed exchange rates to freely floating exchange rates.