

**I. (True/False) For each question, circle T if it is true and F if false.**

1. Generally speaking, any transaction that results in a receipt from foreigners will be recorded as a debit, with a minus sign, in the balance of payments<sup>1)</sup>
2. Debit entries in the U.S. balance of payments give rise to the supply of dollars.(T F )<sup>2)</sup>
3. Credit entries in the Korea balance of payments result from foreign purchases of Korean goods and services. ( T F )<sup>3)</sup>
4. Credit entries in the Korea balance of payments give rise to the demand for KRW.( T F )<sup>4)</sup>
5. In 2017 Korea had a current account deficit. The current account deficit implies that Korea consumed more output than it produced. ( T F )<sup>5)</sup>
6. A country that gives foreign aid to another country can be viewed as exporting goodwill from the latter.( T F )<sup>6)</sup>
7. With regard to the capital and financial account: Korea sales (or exports) of assets are recorded as credits, as they result in capital inflow.( T F )<sup>7)</sup>
8. If the current account is in deficit, it implies that a country's domestic savings is insufficient to finance domestic investment or government budget is in deficit.( T F )<sup>8)</sup>
9. The bid exchange rate is determined by the demand by customers and the supply by market makers. ( T F )<sup>9)</sup>
10. A real appreciation of the foreign currency may lead to an increase in domestic sales.<sup>10)</sup>
11. When CA is positive, it implies that government budget deficits an/or part of domestic investment are being finance with foreign-controlled capital( T F )<sup>11)</sup>
12. A rise in the domestic inflation rate and a simultaneous rise in the foreign inflation

1) False: Result from U.S. purchases of foreign goods and services, goodwill, financial claims, and real assets.

2) True

3) True.

4) True.

5) True

6) False

7) True

8) True.

9) False

10) True

11) False

rate lead to no change in the exchange rate.( T F )<sup>12)</sup>

13. If Korea exports more than it imports, then one can infer that the KRW would be likely to depreciate against other currencies. ( T F )<sup>13)</sup>
14. If the foreign currency equivalent of the domestic price of a commodity is less than the foreign price of the same commodity, then the derivation of PPP implies that the foreign currency is undervalued.( T F )<sup>14)</sup>
15. Assuming the exchange rate is measured in direct quotation and that a PPP trading rule is adopted, if the actual exchange rate is higher than the PPP rate, then: the foreign currency should be bought.( T F )<sup>15)</sup>
16. For an FX dealer, if the forward price is higher than the spot price, then the currency is trading at a premium in the forward market.( T F )<sup>16)</sup>
17. For an FX dealer working in European quotes, if the forward price is higher than the spot price, then the currency is trading at a premium in the forward market. (T F)<sup>17)</sup>
18. UIP implies that: depreciate the currency offering the higher interest rate tends to depreciate). (T F)<sup>18)</sup>
19. The act of simultaneously buying and selling the same or equivalent assets or commodities for the purpose of making guaranteed profits is called hedging. ( T F )<sup>19)</sup>

**II. Quantitative questions.**

20. The LC/FC spot bid-ask rates(LC=Domestic Currency, FC = Foreign Currency) are 1,220-1,225 The 3-month forward points are 1-3. Determine the forward bid-ask rates:<sup>20)</sup>  
A. 1,221 - 1,228 B. 1,228 - 1,221 C. 1,219 - 1,222 D. 1,222 - 1,219
21. The price of a commodity in the US is USD2, while the price of the same commodity in Australia is AUD3 and the AUD/USD exchange rate is 2. What is the Australian dollar price of the commodity compatible with the derivation of PPP? <sup>21)</sup>

12) False: the effect cannot be determined

13) False

14) False: the domestic currency is overvalued

15) False: Sold

16) False: The currency is trading at a discount in the forward market

17) False: The currency is trading at a discount in the forward market

18) True

19) False

20) A

21) C

- A. AUD6.0      B. AUD3.0      C. AUD4      D. AUD1.5

22. At the beginning of 2018 the AUD/USD exchange rate was 1.9585 and the forecast inflation rates for 2018 were 4.00% for Australia and 2.50% for the US. What is the AUD/USD exchange rate forecast to be at the end of 2002, according to PPP theory?<sup>22)</sup>

- A. USD/AUD 1.9872    B. AUD/USD 1.9872  
C. AUD/USD 1.9303    D. none of the given answers

23. The Korean Won/USD\$ spot exchange rate is ₩1200/\$ and the Japanese Yen/\$ is ¥120/\$. The Won/Yen cross exchange rate is:<sup>23)</sup>

- A. 12      B. 1/12      C. 10      D. 1/0

24. What is the BID cross-exchange rate for Swiss Francs priced in euro?<sup>24)</sup>

Country	USD equivalent	
	BID	ASK
Switzerland(Franc) SF	0.5	0.7
Euro €	1.4	1.5

- A. €1/SF3    B. €1/SF2    C. €2/SF1    D. €3/SF1

25. Suppose you observe the following exchange rates: €1 = \$.85; £1=\$1.60; and €2.00= £1.00. Starting with \$1,000,000, how can you make money?<sup>25)</sup>

- A. Exchange \$1m for £625,000 at £1=\$1.60. Buy €1,250,000 at €2 = £1.00; trade for \$1,062,500 at €1 = \$.85.  
B. Start with dollars, exchange for euros at €1 = \$.85; exchange for pounds at €2.00= £1.00; exchange for dollars at £1 = \$1.60.  
C. Start with euros; exchange for pounds; exchange for dollars; exchange for euros.  
D. No arbitrage profit is possible.

26. Suppose you observe a spot exchange rate of LC1040/FC1. If interest rates are 2% APR in the domestic economy and 4% APR in the US., what is the no-arbitrage 1-year forward rate? ( )<sup>26)</sup>

- A. 1000      B. 1020      C. 1060      D. 1200      E. 1400

22) Ans: B

23) C  $\frac{₩1200}{\$1} \times \frac{\$1}{¥120} = \frac{₩1200}{¥120}$

24) A; Hint: Find the price that a currency dealer will pay in euro to buy Swiss francs. You are selling Swiss Francs to get U.S. dollars, (at the USD spot bid price). And then buying euro with U.S. dollars (at the spot USD ask price for euro):

€ 1	=	USD0.5	×	€1.00
CHF 3		CHF1.00		USD1.5

25) A: Start with dollars, exchange for euros at €1 = \$.85; exchange for pounds at €2.00 = 1.00; exchange for dollars at 1 = \$1.60. This is incorrect. If you start with \$1,000 and do this you end up with \$941.18. You need to run it backwards to be the recipient of arbitrage profits, not the source. Exchange \$1m for 625,000 at 1 = \$1.60. Buy €1,250,000 at €2 = 1.00; trade for \$1,062,500 at €1 = \$.85.

26) B

27. Assume that the balance-of-payments accounts for a country are recorded correctly. Balance on the current account = CA = \$130 billion, Balance on the capital and financial account of private sector = KFAp = -\$86 billion, Balance on the reserves account = KFACb = ( ) ?<sup>27)</sup>

- A. -\$44 billion    B. \$44 billion    C. \$216 billion    D. none

28. A long forward position can be constructed by combining:( )<sup>28)</sup>

- A. borrowing in local currency and lending in foreign currency  
B. lending in local currency and borrowing in foreign currency  
C. borrowing in local currency and lending in local currency  
D. borrowing in foreign currency and lending in foreign currency

29. A short(sell) forward position can be constructed by combining: ( )<sup>29)</sup>

- A. a short call and a long put  
B. a long call and a short put  
C. a long call and a long put  
D. a short call and a short put

30. The writer of a call currency option has: ( )<sup>30)</sup>

- A. the right to buy a currency  
B. the right to sell a currency  
C. the obligation to buy a currency  
D. the obligation to sell a currency

31. You are supposed to receive foreign currency after 3 month. You want to hedge your receipt from the exchange rate risk? What's the most proper way of hedging?( )<sup>31)</sup>

- A. Buy futures.  
B. Buy call and sell put  
C. Sell call and buy put  
D. Borrow in local currency and lend in foreign currency

32. The difference between a currency swap and a foreign exchange swap is that:<sup>32)</sup>

- A. in the currency swap, only the principal amount is exchanged  
B. in the currency swap, only interest payments are ever exchanged  
C. in the foreign exchange swap, only the principal amount is exchanged, whereas in a currency swap, a principal amount is usually exchanged at the outset and repayments occur over time involving both principal and interest  
D. in the foreign exchange swap, only interest payments are exchanged

27) A, CA+KFAp = - KFACb; KFACb = -\$44

28) A

29) A

30) D

31) B

32) C