(1)

$2 = 1£ ⇒ New York

¥410 = 1£ London

¥200 = $1 Tokyo

(a) There is arbitrage in the 3-point arbitrage situation since the exchange rate is ~~to be~~ not consistent indirect / cross exchange rate.
⇒ An arbitrager can buy currency in the monetary centre where it is cheaper for immediate resale in the monetary centre where it is more expensive to make profit

(b) An arbitrager can use $2 to purchase 1£ in NewYork. The he can use the 1£ to purchase ¥410 in London.

In Tokyo ¥200 = $1, but the arbitrage has ¥410

So if ¥200 = $1 in Tokyo

the arbitrager can purchase:

¥200 = $1

¥410 ?

$$= \frac{¥410 \times \$1}{¥200} = \$2.05$$

He ~~stel~~ started with $2 and ended up with $2.05 hence making a profit of $0.05 per dollar.

Scanned with CamScanner

2

(a)

	Credit (+)	Debit (-ve)
Unilateral transfers (Barley & Wheat		✓
Capital Inflow	✓	

(b)

	Credit (+)	Debit (-ve)
Goods Export	Textile machinery	

(c)

	Credit (+v)	Debit (-ve)
Hotel expenses	Capital Inflow	

(d)

	Credit	Debit
Indian treasuries		Capital outflow

Scanned with CamScanner

3. C.$1 : 6-month Canadian (TBs)
Yield 1.12% (0.012)

: 6-month Swiss (TBs)
Yield 0.15% (0.005)

Forward Premium is when the forward exchange rate is higher than the spot exchange rate.

Forward discount is when the forward exchange rate is lower than the spot exchange rate.

$$\text{Forward Premium} = \frac{\text{Forward}_{\frac{D}{F}} - \text{Spot}_{\frac{D}{F}}}{\text{Spot}_{\frac{D}{F}}}$$

When the result is (+) = Forward Premium

(−) = forward discount

$$= \frac{1.130 - 1.125}{1.125} = \frac{0.05}{1.25} = 0.04$$

This is a forward Premium *

by $0.05

Scanned with CamScanner

3 (b)

$$\text{Riskless}_{\text{Covered}} = \left(\frac{1 + \text{Government Bond rate}}{1 + \text{Inflation}}\right) - 1$$

$$= \left(\frac{1 + 0.508}{1 + 0.05}\right) - 1$$

$$= 1.4286 - 1 = 0.4286$$

$$= 0.4286\%$$

(c) There is an opportunity of arbitrage since an arbitrager can use purchase a currency from the market where it is cheaper and sell it to the marked where it is expensive hence making profit

(d)

$$= \frac{1.30}{1.25} \times (1 + iy)$$

$$= \frac{1.30}{1.25} \times (1 + 0.005)$$

$$= 1.0452$$

Scanned with CamScanner

3 (e)

$$= \frac{1.130}{0.104} - 1 = 3.15$$

· Expected rate = 3.15

---

4 $65 P = 1 \$$

$600 P = ?$

$$= \frac{600 P \times 1\$}{65 P} = .92.3077$$

(a)

$= \$92.3077$

$$PPP = \frac{92.3077}{100} = 0.9231$$

(b) overvalued by $ 0.0769

This implies that the PESO can purchase or buy more in US.

Scanned with CamScanner

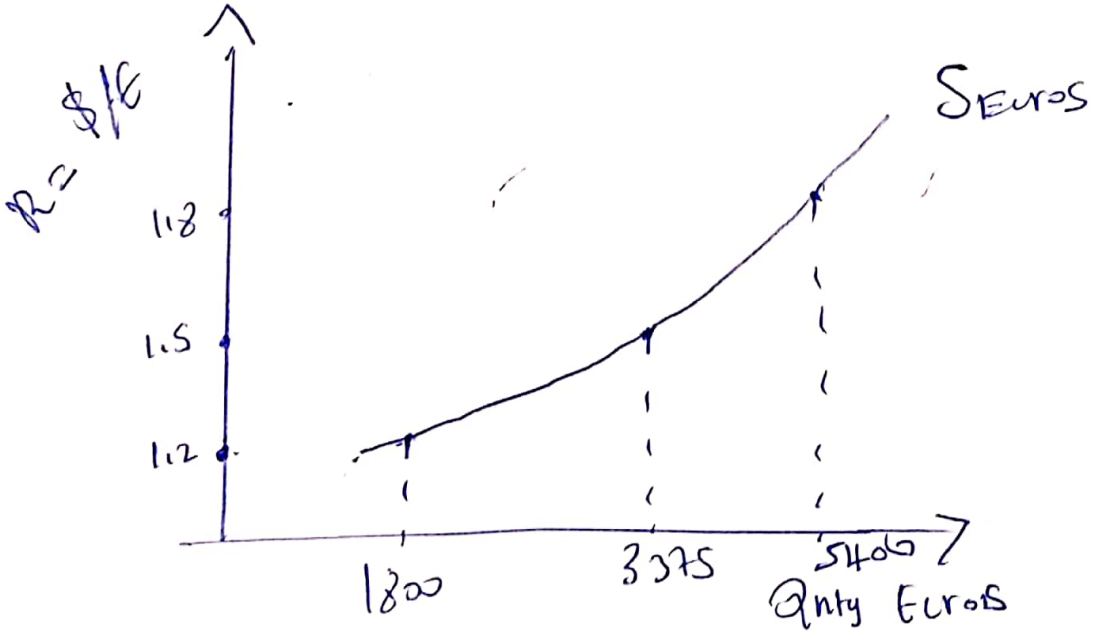
7 EU US

Exports (Cheese) $1 = 1.12 €

Imports (oil from US)

(a)

1	2	3	4
Exchange rate ($/€)	The Euro price of oil (€)	The EU qnty of oil imports	The no. of Euro supplied (€)
1.2	36	50	1800
1.5	45	75	3375
1.8	54	100	5400



Scanned with CamScanner

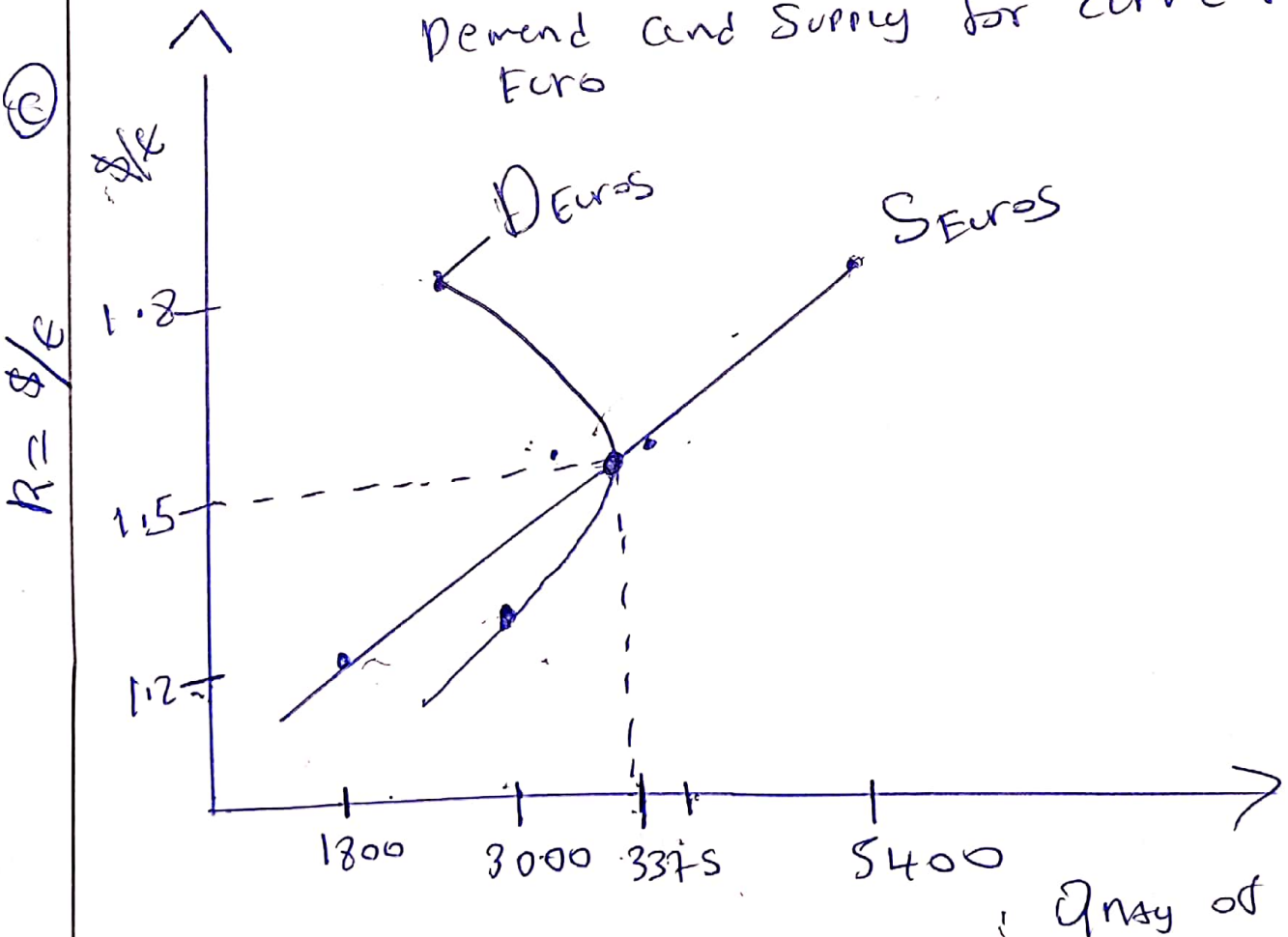
(b) - $100/ton

1$ = 1.2€

1	2	3	4
Exchange rate ($/€)	The euro price of Cheese(€)	The EU qnty of cheese exports	The no of Euro demanded (€)
1.2	120	25	3000
1.5	150	22.5	3375
1.8	180	15.5	2790
~~1.8~~			

(c)

Demand and Supply for curve for Euro



Equilibrium qnty = € 3375

Equilibrium Exchange rate = 1.5 ($/€)

Scanned with CamScanner

7 (d) This foreign exchange market is unstable because a flexible exchange rate system is increasing rathun reducing

Yes
Marshall-lerner Condition is a condition that tells us whether the FOREX market is Sable or unstable.

Marshall-lerner condition indicates a Stable FOREX Market if the sum of the price elasticity of the dd for Imports and the demand for Imports and the demand for export in absolute term is greater than 1 i.e $P_{Imports} + P_{export} > 1 \Rightarrow$ Stable

$P_{Imports} + P_{export} < 1$ - unstable

$P_m + P_{ex} = 1$ · change in exchange rate will leave a BOP unchange.

Scanned with CamScanner