

Name_____.

Class Time & Day_____.

IVC

Irvine Valley College

Homework – Trade, & Investment

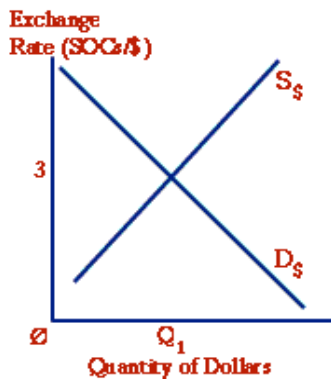
Economics 2

Mark McNeil

Answer these questions neatly and clearly. Please set up the problems and show your work clearly.

1. For each of the following explain what happens in the foreign exchange market (the market in which dollars are purchased and sold).
 - A. Which account is affected?
 - B. Is the transaction a debit or credit transaction?
 - C. Will the supply or demand for dollars be affected?
 - D. Will there be an increase or decrease in supply or demand?
 - E. Which currency will appreciate? Which will depreciate?
 - F. Show these changes on the graph.

- a. McNeil and his brood spend their summer in SOC (try to imagine that he has the money.)



Which account?

Credit or debit?

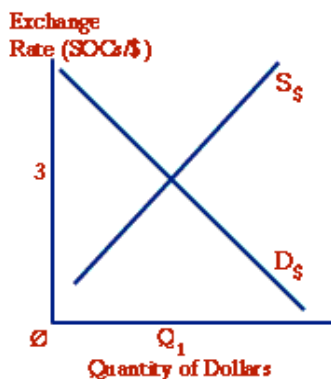
Supply or Demand?

Increase or decrease in S or D

Which currency will appreciate? Depreciate?

Show these changes on the graph.

- b. US firms buy six big buildings in Sochopolis, the capital city of SOC.



Which account?

Credit or debit?

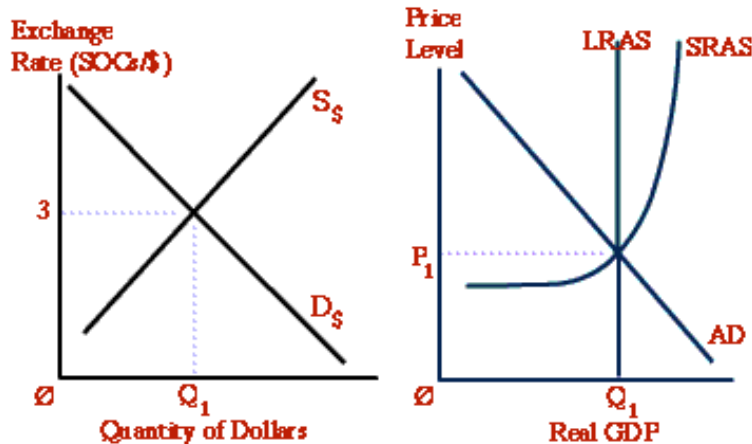
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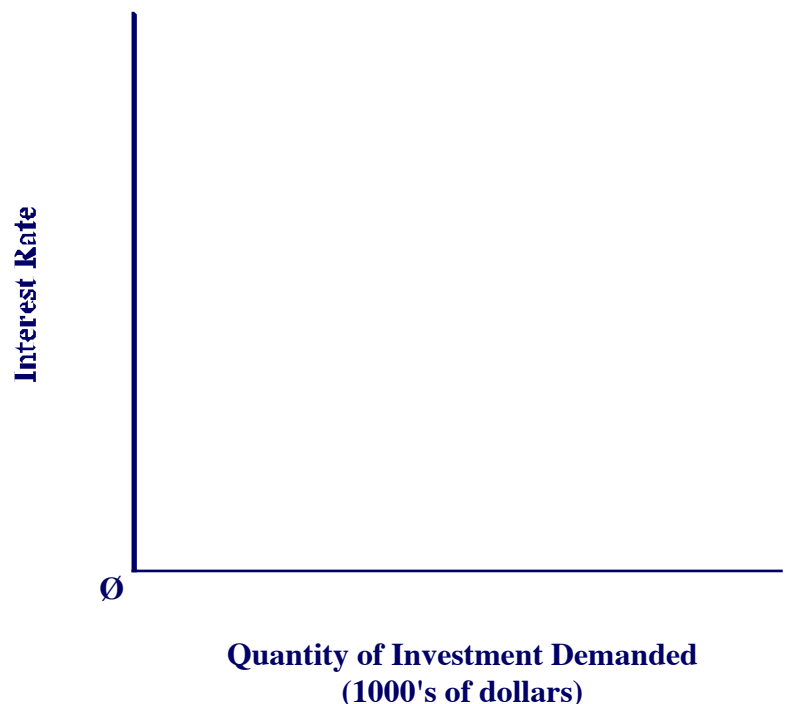
Show these changes on the graph

2. Assume that the supply of dollars in the foreign exchange market decreases; what will happen to the exchange rate, the US price level, and the level of real GDP in the US.



3. Assume that you are a business and that you are considering the purchase of Italian lathe machines. Each machine costs \$50,000. The expected return for each machine purchased is shown in the schedule below.
- Calculate the expected rate of return for each machine.
 - Draw the graph that shows the amount of investment you will undertake at each possible rate of interest (investment demand curve).

Machine #	Yearly Return	Rate of Return
0	0	
1	\$20,000	
2	17,500	
3	15,000	
4	12,500	
5	10,000	
6	7,500	
7	5,000	
8	2,500	
9	1,250	
10	0	



- Draw this firm's investment demand curve.
- If the market rate of interest (the rate at which you borrow the money or the rate at which you forgo interest if you use your own funds) is 21%, how much will you spend on investment goods? If the interest rate is 8%?

4. Assume that there are only two countries in the world, the US and SOC. What if the US wanted to buy very large quantities of goods, services and assets from SOC and that SOC wants to buy very little from the US.

The US will run a trade surplus deficit (circle one) with SOC.

If free trade is permitted between these countries, what will happen in the foreign exchange markets to the rate of exchange between these two countries?

After the exchange rate changes what will happen to the balance of trade? Explain.