

Economics 3107
Global Economic Analysis
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Practice Problems

- I. If the exchange rate between the yen and the dollar is $E_{¥/\$} = 88.85$ and the exchange rate between the dollar and the euro is $E_{\$/\text{€}} = 1.486$, then what is the exchange rate between the yen and the euro, i.e. $E_{¥/\text{€}} = ?$
- II. Suppose the price level in Mexico, PM , is 2280 pesos and the price level in the U.S., P_{US} is 200 dollars, then according to purchasing power parity, what should the peso/dollar exchange rate approximately be?
- III. Consider two currencies, the U.S. dollar and the Euro.
- a. Suppose the U.S. interest rate, $R_{US} = 0.04$, and the Euro zone interest rate is $R_{EZ} = 0.03$. The current exchange rate is, $E_{\$/\text{€}} = 1.31$. In order for the interest parity condition (IPC) to hold, what must the expected dollar/euro exchange rate, $E^e_{\$/\text{€}}$ be?
- b. Suppose the European Central Bank raises R_{EZ} . Explain the effects on:
- the asset market, (use the IPC graph developed in class).
 - the effect on foreign savings in the U.S. market, S_F .
 - the effect on the trade deficit, (use a graph similar to 14.6).