

Chapter 9

Student: _____

1. A stronger Korean won, remembering that Kia cars sold in the United States are paid for in dollars, means what for Kia?
 - A. a need to hedge Japanese yen
 - B. a use for the Euro, a neutral currency
 - C. less profit
 - D. a use for gold to protect against currency fluctuations
 - E. more profit
2. The _____ is a market for converting the currency of one country into that of another.
 - A. foreign exchange market
 - B. cross-cultural interchange
 - C. financial barter market
 - D. monetary replacement market
 - E. international currency spot market
3. The rate at which one currency is converted into another is called the _____.
 - A. replacement percentage
 - B. resale rate
 - C. exchange rate
 - D. interchange ratio
 - E. valuation rate
4. Without the _____ market, international trade and international investment on the scale that we see today would be impossible.
 - A. foreign exchange
 - B. financial barter
 - C. foreign resale
 - D. monetary replacement
 - E. capital market
5. Although the _____ offers some insurance against foreign exchange risk, it cannot provide complete insurance.
 - A. foreign exchange market
 - B. the Euro
 - C. World Bank
 - D. foreign currency exchange
 - E. the CDC
6. The _____ is the market that enables companies based in countries that use different currencies to trade with each other.
 - A. World Bank
 - B. foreign currency exchange
 - C. foreign exchange market
 - D. foreign monetary mart
 - E. foreign exchange mechanism
7. The movement of foreign exchange rates
 - A. provide some insurance against foreign exchange risk.
 - B. has significantly deteriorated the overall volume of foreign trade.
 - C. sets interest rates charged to foreign investors.
 - D. introduces many risks into international trade and investment.
 - E. is a natural function of supply and demand among currency traders

8. When a tourist exchanges one currency into another, she is participating in the:
- A. foreign barter market
 - B. foreign exchange market
 - C. foreign replacement market
 - D. foreign swap market
 - E. international trade exchange
9. The _____ is the rate at which the market converts one currency into another.
- A. international conversion factor
 - B. world barter factor
 - C. foreign exchange rate
 - D. global replacement percentage
 - E. discount rate
10. One function of the foreign exchange market is to provide some insurance against the risks that arise from changes in exchange rates, commonly referred to as:
- A. foreign market hazard.
 - B. global jeopardy.
 - C. foreign exchange risk.
 - D. commerce uncertainty.
 - E. trade payment risk
11. Which of the following statements is true?
- A. The existence of the foreign exchange market has removed all forms of foreign exchange risk for business organizations.
 - B. Despite the existence of the foreign exchange market, firms do suffer losses because of unpredicted . changes in exchange rates, although these occasions are rare.
 - C. The foreign exchange market eliminates very little foreign exchange risk.
 - D. The foreign exchange market is characterized by large numbers of speculators who increase the foreign exchange risk for firms
 - E. Despite the existence of the foreign exchange market, it is not unusual for international businesses to . suffer losses because of unpredicted changes in exchange rates.
12. The foreign exchange market serves two main functions. These are
- A. collect duties on imported products and convert the currency of one country into the currency of another.
 - B. insure companies against foreign exchange risk and set interest rates charged to foreign investors.
 - C. collect duties on imported products and set interest rates charged to foreign investors.
 - D. convert the currency of one country into the currency of another and provide some insurance against foreign exchange risk.
 - E. reduce the trade imbalances between countries and convert the currency of one country into another.
13. The foreign exchange market converts the currency of one country into the currency of another and:
- A. provides some insurance against foreign exchange risk
 - B. collects duties on imported products
 - C. sets interest rates charged to foreign investors
 - D. arbitrates disputes between trade partners
 - E. reduces trade imbalances between countries
14. Tourists are minor participants in
- A. currency conversion exchange
 - B. capital venturing.
 - C. foreign traveling.
 - D. FDI.
 - E. foreign exchange market.

15. Canadian businesses will normally use the _____ in international transactions.
- A. The German mark
 - B. The Euro
 - C. The U.S. dollar
 - D. The Japanese yen
 - E. The British pound
16. Small Canadian businesses will be _____ than large Canadian businesses to be exposed to currency risk associated with the Canadian dollar.
- A. less likely
 - B. unlikely
 - C. likely
 - D. probably likely
 - E. more likely
17. Which of the following is not one of the four main uses that international businesses have for the foreign exchange market?
- A. International businesses use foreign exchange markets to convert money they earn in foreign currencies to their home currencies
 - B. International businesses use foreign exchange markets in determining domestic wage rates
 - C. International businesses use foreign exchange markets when they have spare cash that they wish to invest for short terms in money markets
 - D. Currency speculation
 - E. Short term money market investments
18. _____ typically involves the short-term movement of funds from one currency to another in the hopes of profiting from shifts in exchange rates.
- A. Capital venturing
 - B. Currency speculation
 - C. Monetary risk taking
 - D. Investment contemplation
 - E. Currency conversion
19. Barrick Gold use a(n) _____ strategy to protect itself against changes in the price of gold.
- A. Gold swap
 - B. forward gold exchange
 - C. insurance
 - D. spot gold exchange
 - E. gold hedging
20. Currency speculation typically involves
- A. the short-term movement of funds from one currency to another in the hopes of profiting from shifts in exchange rates.
 - B. the permanent movement of funds from one currency to another in the hopes of profiting from long-term investment in a particular country.
 - C. the simultaneous purchase of currencies from several countries in hopes of profiting from increasing economic prosperity.
 - D. the liquidation of currency in favour of precious metals as a hedge against inflation.
 - E. Buying low and holding currency until it stabilizes, then selling
21. What do many Canadian businesspeople NOT buy into with respect to the value of the Canadian dollar?
- A. A stronger dollar will result in more outbound tourism.
 - B. A weaker dollar is good for tourists coming to Canada
 - C. A stronger dollar means that Canadian resources are more in demand
 - D. A weaker dollar will make imports more expensive
 - E. A stronger dollar will reduce demand for Canada's exports.

22. When two parties agree to exchange currency and execute the deal immediately, the transaction is referred to as a _____.
A. point-in-time exchange
B. temporal exchange
C. spot exchange
D. forward exchange
E. transaction
23. When a U.S. tourist in Japan goes to a bank to convert her dollars into Japanese yen, the exchange rate is the
A. forward exchange rate.
B. regulated exchange rate.
C. sanctioned exchange rate.
D. spot exchange rate.
E. Japanese central bank rate
24. It is necessary to use a _____ exchange rate to execute a transaction immediately.
A. real time
B. spot
C. statutory
D. sanctioned
E. bank determined
25. _____ are reported daily in financial pages of newspapers.
A. Real time rates
B. Spot exchange rates
C. Sanctioned rates
D. Statutory exchange rates
E. Hedging costs
26. The value of a currency is determined by
A. the interaction between the demand and supply of that currency relative to the demand and supply of other currencies.
B. a consortium of international currency traders.
C. the World Trade Organization.
D. negotiations between the central banks of the leading five industrial powers of the world.
E. currency speculators
27. A _____ exchange occurs when two parties agree to exchange currency and execute the deal at some specific date in the future.
A. reverse
B. spot
C. hedge
D. forward
E. futures
28. _____ exchange rates represent market participants' collective predictions of likely spot exchange rates at specified future dates.
A. Reciprocal
B. Hedge
C. Reverse
D. Forward
E. Future

29. A(n) _____ is purchase and sale of a given amount of foreign exchange for two different value dates, at the same time.
- A. currency swap
 - B. FDI
 - C. economic fund
 - D. short selling
 - E. arbitrage group
30. Which of the following correctly matches a country with its currency?
- A. South Korea, the pound
 - B. France, the deutsche mark
 - C. Japan, the yuan
 - D. Great Britain, the franc
 - E. Brazil, the real
31. Which of the following correctly matches a country with its currency?
- A. Japan, the yuan
 - B. South Korea, the baht
 - C. Canada, the yen
 - D. Great Britain, the pound
 - E. China, the rand
32. Which of the following is the currency of France?
- A. Pound
 - B. Deutsche mark
 - C. Dollar
 - D. Franc
 - E. Euro
33. _____ occurs when an investor purchases securities in one market for immediate resale in another.
- A. Hedge fund
 - B. Foreign direct investment
 - C. Foreign exchange risk
 - D. Arbitrage
 - E. Financial gain
34. An importer enters into a 60 day forward exchange rate for converting dollars into yuan. The spot exchange rate is 5.28 yuan for 1 dollar. The forward exchange rate is 5.27 yuan for 1 dollar. How many yuan would the importer get for 50,000 dollars
- A. 264,000
 - B. 364,000
 - C. 364,500
 - D. 353,500
 - E. 263,500
35. An importer enters into a 60 day forward exchange rate for converting dollars into yuan. The spot exchange rate is 5.28 yuan for 1 dollar. The forward exchange rate is 5.27 yuan for 1 dollar. What is the difference in the amount the importer receives using the forward exchange rate and the spot exchange rate.
- A. 100,000
 - B. 5,000
 - C. 500
 - D. 50
 - E. 250

36. Rates for currency exchange quoted for 30, 90, or 180 days into the future are referred to as _____.
- A. forward exchange rates
 - B. foreign exchange quotes
 - C. united trade rates
 - D. generic exchange quotes
 - E. future exchange rates
37. Current estimates are that currencies worth approximately _____ trillion dollars (U.S.) were traded every day.
- A. 1
 - B. 200
 - C. 13
 - D. 4.2
 - E. 4
38. In 2006, the Canadian dollar ranked _____ among all the currencies traded in the world on futures exchanges.
- A. 14
 - B. 7
 - C. 25
 - D. 35
 - E. 27
39. When the dollar buys more francs on the spot market than the 30-day forward market, we say the dollars is selling at a _____. Conversely, when the dollars buys less francs on the spot market than the 30-day forward market, we say the dollar is selling at a _____.
- A. premium; discount
 - B. handicap; bonus
 - C. discount; premium
 - D. subsidy; handicap
 - E. gain; loss
40. The foreign exchange market:
- A. is not located in any one place
 - B. is located in New York City
 - C. has offices in the Capitols of the five most powerful industrialized nations in the world
 - D. is located in London
 - E. is managed by the UN
41. The most important trading centers for the foreign exchange market are in
- A. New York, Singapore, Tokyo
 - B. San Paulo, New York, and Paris
 - C. San Francisco, Tokyo, and Singapore
 - D. New York, Hong Kong, and Paris
 - E. London, New York, and Tokyo
42. One feature of the London exchange market is _____
- A. Lower exchange fees
 - B. Higher margins
 - C. New investment products
 - D. The ability to short the market
 - E. Its geography between the Tokyo and New York Markets

43. Which of the following is a feature of the foreign exchange market?
- A. The market never sleeps
 - B. The market has not yet created a global link
 - C. There are not yet significant differences in the exchange rates
 - D. High-speed computer linkages between trading centers have yet to be created
 - E. Prices for various currencies are primarily set in New York and London
44. The largest trading center in the foreign exchange market is _____.
- A. Hong Kong
 - B. London
 - C. San Paulo
 - D. Paris
 - E. New York
45. The process of buying a currency low and selling it high at the same time is called
- A. forward exchange.
 - B. skimming
 - C. profiteering
 - D. arbitrage
 - E. hedging
46. If the prices differed in London and New York and a dealer spent \$1 million to purchase ¥125 million, then sold that ¥125 immediately for \$1.046666 million, the trader would earn a profit of \$46,666 on the transaction. This is accomplished through
- A. arbitrage
 - B. skimming
 - C. FDI.
 - D. pre exchange agreements
 - E. buying low and selling high
47. Although a foreign exchange transaction can involve any two currencies, most transactions involve
- A. Japanese yen
 - B. British pounds
 - C. U.S. dollars
 - D. French francs
 - E. Euros
48. At the most basic level, exchange rates are determined by the demand and supply of one currency relative to the
- A. permanent value of another
 - B. 30-day average of another
 - C. 90-day average of another
 - D. demand and supply of another
 - E. market psychology
49. Most economic theories suggest that three import factors have an important impact on future exchange rate movements in a country's currency. These factors are
- A. the country's price inflation, its interest rate, and its market philosophy.
 - B. the country's rate of GNP, its unemployment rate, and its economic policy.
 - C. the country's participation in the World Trade Organization, its monetary policy, and its market philosophy.
 - D. the country's rate of economic growth, its participation in the World Trade Organization, and its economy policy.
 - E. the country's economic policy, its trade balance, and its national deficits

50. The three factors that have the most important impact on future exchange rate movement include the country's price inflation, its market philosophy, and its _____.
A. rate of economic growth
B. unemployment rate
C. interest rate
D. participation in the World Trade Organization
E. current account balance
51. The law of one price and purchasing power parity are two components of
A. market psychology
B. price and exchange rates
C. interest rate
D. prices inflation
E. economic theory
52. The _____ states that in competitive markets free of transportation costs and barriers to trade, identical products sold in different countries must sell for the same price when their price is expressed in terms of the same currency.
A. law of one price
B. principle of consistent pricing
C. model of fair pricing
D. principle of equitable pricing
E. law of purchasing power equity
53. According to the _____, identical products sold in different countries must sell for the same price when their price is expressed in the same currency in competitive markets free of transportation costs and barriers to trade.
A. model of fair pricing
B. law of purchasing power equity
C. principle of equitable pricing
D. principle of consistent pricing
E. law of one price
54. The exchange rate between the British pound and the dollar is $\pounds 1 = \$1.50$ and a jacket that retails for \$75 in New York sells for $\pounds 50$ in London ($\$75/1.5 = \pounds 50$). This reflects
A. model of fair pricing.
B. law of one price.
C. principle of equitable pricing.
D. principle of consistent pricing.
E. purchasing power equity
55. The text gives Bolivia as an example of the impact of _____ on exchange rates.
A. interest rates
B. trade imbalances
C. market psychology
D. bad economic management
E. money supply
56. PPP theory stands for
A. Productivity Power Premium theory.
B. Process Productivity Predictor theory.
C. Purchasing Power Parity theory.
D. Personal Power Predictor theory.
E. Production Possibilités Parameter

57. A(n) _____ has no impediments to the free flow of goods and services.
- A. classical market
 - B. efficient market
 - C. traditional market
 - D. inefficient market
 - E. free market
58. A less extreme version of the PPP theory state that given _____ the price of a "basket of goods" should be roughly equivalent in each country.
- A. tolerant markets
 - B. relatively efficient markets
 - C. classical markets
 - D. closed markets
 - E. free markets
59. If the law of one price were true for all goods and services, the _____ exchange rate could be found from any individual set of prices.
- A. stability power similarity (SPS)
 - B. purchasing ability adeptness (PAA)
 - C. buying prowess equality (BPE)
 - D. purchasing power parity (PPP)
 - E. spot
60. A(n) _____ is a market in which few impediments to international trade and investment exist.
- A. relatively efficient market
 - B. consistently inefficient market
 - C. absolutely free market
 - D. absolutely closed
 - E. free market
61. The _____ theory tells us that a country with a high inflation rate will see depreciation in its currency exchange rate.
- A. law of one price
 - B. monetary system
 - C. PPP
 - D. price inflation
 - E. currency determinism
62. In essence, PPP theory predicts that
- A. there is no relationship between changes in relative prices and changes in exchange rates.
 - B. changes in relative prices will result in stability in exchange rates.
 - C. stability in relative prices will result in a change in exchange rates.
 - D. changes in relative prices will result in a change in exchange rates.
 - E. changes in market barriers will result in changes in exchange rates
63. A less extreme version of the PPP theory states that given _____, that is, markets in which few impediments to international trade and investment exist-the price of a "basket of goods" should be roughly equivalent in each country.
- A. relatively efficient markets
 - B. statutory markets
 - C. stable markets
 - D. absolutely free markets
 - E. mixed economies

64. In essence, the _____ theory predicts that changes in relative prices will result in a change in exchange rates.
- A. buying power equality (BPE)
 - B. purchasing power parity (PPP)
 - C. stability power similarity (SPS)
 - D. buying prowess equality (BPE)
 - E. price stabilization potential
65. Theoretically, a country in which price inflation is running wild should expect to see its currency depreciate against that of countries in which inflation rates are lower refers to
- A. buying purchase power.
 - B. purchasing power parity.
 - C. power similarities.
 - D. comparative advantage.
 - E. national competitive disadvantage
66. The Canadian money supply is growing more rapidly than Canadian output. Dollars will be relatively more plentiful than the currencies of countries where monetary growth is closer to output growth. This is an example of
- A. buying purchase power.
 - B. buying prowess equality.
 - C. stability power similarities.
 - D. purchasing power parity.
 - E. inflationary pressures
67. Inflation is a _____ phenomenon.
- A. legal
 - B. political
 - C. monetary
 - D. social
 - E. economic
68. According to our textbook, when the growth in a country's money supply is faster than the growth in its output, _____ is(are) fuelled.
- A. economic growth
 - B. unemployment
 - C. inflation
 - D. per capita savings
 - E. wage increases
69. The PPP theory tells us that a country with a high inflation rate will see:
- A. a depreciation in its currency exchange rate
 - B. an appreciation in its currency exchange rate
 - C. no change in its currency exchange rate as a result of the inflation rate
 - D. economic stability as a result of high inflation
 - E. price rises to match neighbouring country prices
70. Economic theory tells us that _____ rates reflect expectations about likely future inflation rates.
- A. currency
 - B. exchange
 - C. interest
 - D. unemployment
 - E. forward

71. _____ determines whether the rate of growth in a country's money supply is greater than the rate of growth in output.
- A. The international monetary authority
 - B. Market mechanisms
 - C. The private sector
 - D. Government policy
 - E. Demand for money
72. The inevitable result of excessive growth in money supply is called
- A. interest rate.
 - B. price inflation.
 - C. economic growth.
 - D. per capita savings.
 - E. wage increases
73. PPP theory predicts that changes in _____ will result in a change in exchange rates.
- A. relative prices
 - B. interest rates
 - C. unemployment rates
 - D. statutory prices
 - E. wholesale prices
74. According to the textbook, PPP theory does not seem to be a particularly good predictor of exchange rate movements for time spans of
- A. one year or less
 - B. three years or less
 - C. five years or less
 - D. ten years or less
 - E. twenty years or less
75. The _____ is less useful for predicting exchange movements between the currencies of advanced industrialized nation that have relatively small differentials in inflation rates.
- A. tolerant market
 - B. efficiency theory
 - C. PPP theory
 - D. closed market
 - E. supply and demand mechanism
76. The PPP theory seems to best predict exchange rate changes for countries with
- A. very low rates of inflation and developed capital markets.
 - B. very low rates of inflation and underdeveloped capital markets.
 - C. very high rates of inflation and underdeveloped capital markets.
 - D. very high rates of inflation and developed capital markets.
 - E. low rates of inflation and underdeveloped capital markets
77. The _____ states that for any two countries, the spot exchange rate should change in an equal amount but in the opposite direction to the difference in the nominal interest rates between the two countries.
- A. Worldwide James Effect
 - B. Universal Phillips Effect
 - C. International Fisher Effect
 - D. Global Miller Effect
 - E. Law of One Price Effect

78. The International Fisher Effect states that for any two countries, the _____ exchange rate should change in an equal amount but in the opposite direction to the difference in the nominal interest rates between the two countries.
- A. reciprocal
 - B. spot
 - C. forward
 - D. inward
 - E. future
79. According to the Fisher effect, if the real rate of interest in a country is 5 percent and the annual inflation is expected to be 10 percent, the nominal interest rate will be
- A. 5 percent.
 - B. 10 percent.
 - C. 12.5 percent
 - D. 15 percent.
 - E. 20 percent.
80. Empirical evidence suggests that neither PPP theory nor the International Fisher Effect is particularly good at explaining
- A. long-term movements in exchange rates.
 - B. interest rates.
 - C. short-term movements in exchange rates.
 - D. unemployment rates.
 - E. short-term wage levels
81. Short run exchange rate movements may be explained by _____?
- A. The bandwagon effect
 - B. Investor expectations
 - C. Psychological factors
 - D. Nominal interest rates
 - E. A, B and C are correct
82. Calculate the forward exchange rate using the following information. spot exchange rate is \$1.45 for 1 Euro. The nominal interest rate in Canada is 6 percent and the nominal interest rate in Europe is 4%.
- A. 1.44
 - B. 1.43
 - C. 1.45
 - D. 1.41
 - E. 1.42
83. Investor expectations about likely future exchange rates have a tendency to become _____?
- A. the PPP
 - B. speculative exchange rates
 - C. self-fulfilling prophecies
 - D. the IFE
 - E. interest rates
84. The _____ market school argues that forward exchange rates do the best possible job of forecasting future spot exchange rates, so investing in exchange rate forecasting services would be a waste of time.
- A. efficient
 - B. closed
 - C. inefficient
 - D. free
 - E. open

85. The _____ market school argues that companies can improve the foreign exchange market's estimate of future exchange rates by investing in forecasting services.
- A. inefficient
 - B. free
 - C. open
 - D. closed
 - E. efficient
86. A(n) _____ market is one in which prices do not reflect all available information.
- A. efficient
 - B. inefficient
 - C. free
 - D. closed
 - E. regulated
87. In an _____ market, forward exchange rates will not be the best possible predictors of future spot exchange rates.
- A. closed
 - B. inefficient
 - C. efficient
 - D. reciprocal
 - E. regulated
88. _____ draws on economic theory to construct sophisticated econometric models for predicting exchange rate movements.
- A. Principal investigation
 - B. Fundamental analysis
 - C. Primary evaluation
 - D. Technical analysis
 - E. Economic analysis
89. The variables in fundamental analysis models can include
- A. price
 - B. volume
 - C. investor psychology
 - D. the bandwagon effect
 - E. money supply
90. _____ uses price and volume data to determine past trends, which are expected to continue into the future.
- A. Principal investigation
 - B. Primary evaluation
 - C. Fundamental analysis
 - D. Technical analysis
 - E. Econometric analysis
91. The type of analysis that predicts exchange rate movements by using price and volume data to determine past trends is called
- A. fundamental analysis.
 - B. primary evaluation.
 - C. technical analysis.
 - D. principal investigation.
 - E. econometric analysis

92. _____ is based on the premise that analyzable market trends and waves can be used to predict future trends and waves.
- A. Technical analysis
 - B. Fundamental analysis
 - C. Basic analysis
 - D. Central analysis
 - E. Econometric analysis
93. Because there is no theoretical rationale for assumptions of predictability, many economists compare _____ to fortune telling.
- A. technical analysis
 - B. PPP
 - C. exchange rate analysis
 - D. inflation rates
 - E. currency speculation
94. A country's currency is said to be _____ when the country's government allows both residents and non-residents to purchase unlimited amounts of foreign currency with it.
- A. technically convertible
 - B. freely convertible
 - C. externally convertible
 - D. nonconvertible
 - E. internally convertible
95. _____ is most likely to occur when the value of the domestic currency is depreciating rapidly because of hyperinflation.
- A. Counter trade
 - B. Separate trade
 - C. Reciprocal trade
 - D. Capital flight
 - E. Run on banks
96. A currency is said to be _____ when only non-residents may convert it into a foreign currency without any limitations.
- A. externally convertible
 - B. freely convertible
 - C. technically convertible
 - D. nonconvertible
 - E. internally convertible
97. A currency is _____ when neither residents nor non-residents are allowed to convert it into a foreign currency.
- A. freely convertible
 - B. nonconvertible
 - C. externally convertible
 - D. technically convertible
 - E. inconvertible
98. A government restricts the convertibility of its currency to protect the country's _____ and to halt any capital flight.
- A. membership in the World Trade Organization
 - B. foreign exchange reserves
 - C. political stature
 - D. national sovereignty
 - E. economic stability

99. _____ refers to a range of barter-like agreements by which goods and services can be traded for other goods and services.
- A. Separate trade
 - B. Reciprocal trade
 - C. Counter trade
 - D. Alternative trade
 - E. Cashless trade
100. If an Canadian grain company exported corn to Russia, and instead of receiving nonconvertible Russian currency in exchange for the corn received Russian crude oil, that would be an example of _____.
- A. counter trade
 - B. synergistic trade
 - C. separate trade
 - D. reciprocal trade
 - E. barter trade
101. Currency exchange fluctuations are important for a business to understand because they can _____.
- A. affect profitability in a international transaction
 - B. affect pricing in a country market
 - C. affect the competitive advantage of a company
 - D. increase costs for imported goods
 - E. all of these answers are correct
102. A stronger Korean won means that Kia cars sold in Canada for dollars are recorded at a higher value when translated back into won.
True False
103. The international reserve market is a market for converting the currency of one country into that of another country.
True False
104. Without the foreign market exchange, international trade and international investment on the scale that we see today would be impossible.
True False
105. In addition to altering the value of trade deals and foreign investments, currency movements can also open or close export opportunities and alter the attractiveness of imports.
True False
106. An exchange rate is simply the rate at which one currency is converted into another.
True False
107. In international trade, the risk of not getting paid for a product that is exported from one country to another is referred to foreign exchange risk.
True False
108. The market through which an individual or institution exchanges one currency into another is called the foreign exchange market.
True False
109. When a tourist changes one currency into another, she is participating in currency speculation.
True False
110. Tourists play a major role in the foreign exchange market.
True False

111. Currency speculation typically involves the short-term movement of funds from one currency to another in the hopes of profiting from shifts in exchange rates.
True False
112. When a Canadian tourist in Edinburgh goes to a bank to convert her dollars in pounds, the exchange rate is the forward exchange rate.
True False
113. Spot exchange rates change daily as determined by the relative demand and supply for different currencies.
True False
114. A forward exchange occurs when two parties agree to exchange currency and execute the deal at some specific date in the future.
True False
115. A forward exchange is an investment fund that not only buys financial assets but also sells them short.
True False
116. A currency swap is the simultaneous purchase and sale of a given amount of foreign exchange for two different value dates.
True False
117. Arbitrage is the process of buying a currency high and selling it low.
True False
118. At the basic level, exchange rates are determined by the demand and supply of one currency relative to the demand and supply for another.
True False
119. The law of one price states that identical products sold in different countries must sell for the same price when their price is expressed in the same currency in competitive markets free of transportation costs and barriers to trade.
True False
120. According to the International Fisher Effect, for any two countries, the spot exchange rate should change in an equal amount but in the opposite direction to the difference in the nominal interest rates between the two countries.
True False
121. An efficient market has significant impediments to the free flow of goods and services.
True False
122. An efficient market is one in which prices reflect all available public information.
True False
123. Fundamental analysis uses price and volume data to determine past trends, which are expected to continue into the future.
True False
124. Technical analysis draws on economic theory to construct sophisticated econometric models for predicting exchange rate movements.
True False
125. A currency is said to be externally convertible when only non-residents may convert it into foreign currency without limitations.
True False

126. A country's currency is said to be freely convertible when neither residents nor non-residents are allowed to convert it into a foreign currency.
True False
127. The majority of the countries in the world have currency that is freely convertible.
True False
128. Counter trade refers to a range of barter-like agreements by which goods and services can be traded for other goods and services.
True False
129. What are the functions of the foreign exchange market? Would international commerce be possible without its existence?
130. For a firm that deals in international markets, what does "foreign exchange risk" mean? How could foreign exchange risk affect the profitability of a Canadian agricultural equipment firm exporting tractors to a German buyer?
131. Explain the difference between spot exchange rates and forward exchange rates. Briefly explain how the forward exchange market works.
132. Where is the foreign exchange market located? What is the nature of the market? Is the market growing or shrinking on a global basis?

133. What is the International Fisher Effect? (note: you do not need to provide the mathematical formula provided in the book)
134. Explain how the psychology of investors and bandwagon effects can have an impact on the movement in exchange rates. Do you believe that bandwagon effects really happen? Explain your answer.
135. In the context of forecasting exchange rate movements, describe the difference between fundamental analysis and technical analysis. Which approach is preferred by economists? Why?
136. Explain the concept of counter trade. When does counter trade make sense? How does counter trade help solve the no convertibility problem?
137. Why do companies prefer not to use counter trade if it can be avoided?

138. The Canadian dollar has been appreciating against the US dollar, but has held steady against other currencies. You have been asked by the CEO to prepare a marketing plan for entering EU countries. One of the key elements of your marketing plan is to price in Euros. What are the pros and cons of this currency strategy?
139. Your company has decided to enter the Argentinean market with a product line of automobile accessories. You have decided to use two wholesalers, who will distribute to the retail market. The potential size of the market is \$10,000, 000 USD per year. However, both of your wholesalers will not assume the risk of invoices charging USD and they want at least 60 days before paying. They argue that they will have to give their retailers 60 days to pay and their retailers will only pay them in pesos. Argentina has just come out of a currency crisis and your Canadian bank has warned you of possible severe currency fluctuations. What payment and currency strategy will you suggest to your senior management? Explain your answer.
140. The Canadian dollar has risen against the U.S. dollar. Many manufacturers are complaining that this rise may affect their U.S. export market. Explain.
141. What factors will have an impact on the value of the Canadian dollar in six months time. Make a prediction as to whether the dollar will rise or fall against the following currencies: U.S. dollar, Euro, Yuan. Justify your answer.

Chapter 9 Key

1. (p. 298) C
2. (p. 300) A
3. (p. 300) C
4. (p. 300) A
5. (p. 300, 301) A
6. (p. 300) C
7. (p. 301) D
8. (p. 301) B
9. (p. 301) C
10. (p. 301) C
11. (p. 300, 301) E
12. (p. 301) D
13. (p. 301) A
14. (p. 302) E
15. (p. 302) C
16. (p. 304) E
17. (p. 301, 302) B
18. (p. 302) B
19. (p. 303) E
20. (p. 302) A
21. (p. 304) E
22. (p. 305) C
23. (p. 305) D
24. (p. 305) B
25. (p. 305) B
26. (p. 305) A
27. (p. 305) D
28. (p. 305) D
29. (p. 307) A
30. (p. 306) E
31. (p. 306) D
32. (p. 306) E
33. (p. 309) D
34. (p. 307) E
35. (p. 307) C
36. (p. 307) A

37. (p. 307) E
38. (p. 308) E
39. (p. 307) C
40. (p. 308) A
41. (p. 308) E
42. (p. 308) E
43. (p. 308) A
44. (p. 308) B
45. (p. 309) D
46. (p. 309) A
47. (p. 309) C
48. (p. 309) D
49. (p. 310) A
50. (p. 310) C
51. (p. 310) B
52. (p. 310) A
53. (p. 310) E
54. (p. 310) B
55. (p. 313) E
56. (p. 310) C
57. (p. 310) B
58. (p. 310) B
59. (p. 310) D
60. (p. 310) A
61. (p. 310, 311) C
62. (p. 311) D
63. (p. 310) A
64. (p. 310, 311) B
65. (p. 311, 313) B
66. (p. 311, 313) D
67. (p. 313) C
68. (p. 313) C
69. (p. 313) A
70. (p. 313) C
71. (p. 314) D
72. (p. 313) B
73. (p. 314) A
74. (p. 314, 315) C

75. (p. 314) C
76. (p. 314) C
77. (p. 318) C
78. (p. 318) B
79. (p. 318) D
80. (p. 318) C
81. (p. 318) E
82. (p. 318) E
83. (p. 318) C
84. (p. 319) A
85. (p. 319) E
86. (p. 319, 320) B
87. (p. 319, 320) B
88. (p. 320) B
89. (p. 320) E
90. (p. 320) D
91. (p. 320) C
92. (p. 320) A
93. (p. 320, 321) A
94. (p. 321) B
95. (p. 321) D
96. (p. 321) A
97. (p. 321) B
98. (p. 321) B
99. (p. 322) C
100. (p. 322) A
101. (p. 323) E
102. (p. 298) FALSE
103. (p. 300) FALSE
104. (p. 300) TRUE
105. (p. 300) TRUE
106. (p. 300) TRUE
107. (p. 301) FALSE
108. (p. 301) TRUE
109. (p. 302) FALSE
110. (p. 302) FALSE
111. (p. 302) TRUE
112. (p. 305) FALSE

113. (p. 305) TRUE

114. (p. 307) TRUE

115. (p. 307) FALSE

116. (p. 307) TRUE

117. (p. 309) FALSE

118. (p. 309) TRUE

119. (p. 310) TRUE

120. (p. 316) TRUE

121. (p. 310) FALSE

122. (p. 310) TRUE

123. (p. 320) FALSE

124. (p. 320) FALSE

125. (p. 321) TRUE

126. (p. 321) FALSE

127. (p. 321) FALSE

128. (p. 322) TRUE

It is difficult to image how international commerce would work without the existence of the foreign exchange market. Without it, international trade would have to be completed on the basis of barter, rather than currency exchange. As suggested by the author of the textbook, the foreign exchange markets is the lubricant that enables companies based in countries that use different currencies to trade with each other.

129. (p. 300-302) The foreign exchange market is a market for converting the currency of one country into that of another. For example, a Canadian exporter that gets paid by a German importer in deutsche marks can convert the deutsche marks to dollars on the foreign exchange market. The two main functions of the foreign exchange market are currency conversion and insuring against foreign exchange risk. In terms of currency conversion, the market has four primary functions for international businesses: (1) converting payments a company receives in foreign currencies into the currency of its home country; (2) converting the currency of a company's home country into another currency when they must pay a foreign company for its products and services in their currency; (3) international businesses may use foreign exchange markets when they have spare cash that they wish to invest for short terms in money markets (of another country); and (4) currency speculation. The second function of the foreign exchange market is to provide insurance to protect against the possible adverse consequences of unpredictable changes in exchange rates. This can be accomplished through the use of a forward exchange.

130. (p. 301) A foreign exchange risk is a risk that the value of currencies will change in the future. A change in foreign exchange rates could have a dramatic impact on a company engaged in international commerce. For example, if a Canadian agricultural equipment firm had a contract to deliver 100 tractors to a German customer in three months, and the Canadian dollar strengthened against the Euro (i.e. currency values changed), the Canadian agricultural equipment firm would end up with less dollars (after the Euro it was paid were exchanged for dollars) than originally anticipated.

Forward exchange rates are rates for currencies quoted for 30, 90, or 180 days into the future (in some cases, it is possible to get forward exchange rates for several years into the future). Forward exchange rates are available because of the volatile and problematic nature of the spot exchange market. Suppose a Canadian importer agreed to pay a Japanese exporter \$100 a piece for a large quantity of cameras. The day of the agreement, the exchange rate for dollars and yen was 1:1 (1 dollar for 1 yen). The Canadian importer planed to sell the cameras for \$125, guaranteeing him a profit of \$25 per camera. Further suppose that the payment is not due to the Japanese exporter for 30 days, and during the 30 day waiting period, the dollar unexpectedly depreciates against the yen, forcing the exchange rate to one dollar for every .75 yen. Per the original agreement, the Canadian importer still has to pay the Japanese importer 100 yen per camera, but now the exchange rate is not 1 dollar per yen, but is 1 dollar per .75 yen. As a result, the Canadian importer has to pay \$1.33 to buy the equivalent of 1 yen. Now, instead of making \$25 per camera (\$125 selling price - \$100 purchase price), the Canadian importer will lose \$8 per camera (\$125 selling price - \$133 purchase price influenced by currency fluctuations). To avoid this potential problem, the Canadian importer could have entered into a 30-day forward exchange transaction with a foreign exchange dealer at, say, 1 dollar for every .95 yen (the forward rate will typically be somewhat lower than the spot rate). By doing this, the importer is guaranteed that he or she will not have to pay more than 1.05 dollars for every 1 yen, which would still guarantee the importer a \$20 per profit on the cameras.

131. (p. 305-307) The spot exchange rate is the rate at which a foreign exchange dealer converts one currency into another currency on a particular day. Thus, when a Japanese tourist in Vancouver goes to a bank to convert yen into dollars, the exchange rate is the spot rate for that day. Spot exchange rates change daily, based on the relative supply and demand for different currencies.

132. (p. 308) The foreign exchange market is not located in any one place. It is a global network of banks, brokers, and foreign exchange dealers connected by electronic communications systems. When companies wish to convert currencies, they typically go through their own banks rather than entering the market directly. The foreign exchange market has been growing at a rapid pace, reflecting a general growth in the volume of cross-border trade and investment.

133. (p. 316-318) The International Fisher Effect states that for any two countries, the spot exchange rate should change in an equal amount but in the opposite direction to the difference in nominal interest rates between the two countries.

Ask your students if they believe bandwagon effects actually happen in practice. Most students will say that they do, and have vivid examples to support their conclusions.

134. (p. 318) As noted by the author of the textbook, empirical evidence suggests that empirical explanations are not particularly good at explaining short-term movements in exchange rates. One reason for this may be the impact of investor psychology on short-run exchange rate movements. Investors, because they are human beings, do not always make decisions based on a rational analysis of the facts. Sometimes investors imitate the actions of someone that is very influential, even if there is no logical reason to do so. Investors also trade based on "hunches" or speculation, which is more psychological in nature than rational. A bandwagon effect is when investors in increasing numbers start following the lead of someone who may be pushing the value of a currency up or down due to psychological reasons. As a bandwagon effect builds up, the expectations of investors become a self-fulfilling prophecy, and the market moves in the way the investors expected.

Since there is no theoretical rationale for the assumption of predictability that underlies technical analysis, most economists compare technical analysis to fortune-telling, and prefer fundamental analysis. However, despite this scepticism, technical analysis has gained favour in recent years.

135. (p. 320-321) Fundamental analysis draws on economic theory to construct sophisticated econometric models for predicting exchange rate movements. The variables contained in these models typically include relative money supply growth rates, inflation rates, and interest rates. In addition, they may include variables related to a country's balance-of-payments positions. In contrast, technical analysis uses price and volume data to determine past trends, which are expected to continue into the future. This approach does not rely on a consideration of economic fundamentals. Technical analysis is based on the premise that there are analyzable market trends and waves and that previous trends and waves can be used to predict future trends and waves.

136. (p. 322) Counter trade refers to a range of barter-like agreements by which goods and services can be traded for other goods and services. Counter trade makes sense when a country's currency is nonconvertible. For example, the Russian rouble is nonconvertible. What that means is that if a Canadian exporter sold grain to a Russian importer and was paid in roubles, the Canadian exporter could not take the roubles to a bank and have them converted into dollars. The roubles are only of value in Russia. To get around this limitation, the Canadian exporter and the Russian importer might enter into a counter trade agreement, in which the Canadian exporter accepts some type of goods or services in exchange for the grain rather than Russian roubles. For instance, the Russian importer could use roubles to buy Russian crude oil, and exchange the crude oil for the grain. The Canadian exporter could then sell the crude oil for American dollars, and benefit from the transaction.

137. (p. 322) Counter trade requires a company to set up a sales department to sell the goods that it receives in exchange for the goods it is selling. Most companies are expert in their own areas of specialization but are not expert in determining the price of goods outside of their specialization. Another reason may be how does one determine what is a fair valuation for the bartered goods.

138. (p. 305-308) The student may answer that the movement in the exchange rate will be the biggest unknown. The Euro has been appreciating against the Canadian dollar and this could lead to two different scenarios. The first, is that the profitability of your sales will increase. The second is that you may have to make adjustments to your price because of changes that competitors have made to reflect the higher exchange rate. However there also may be the scenario where the Euro will decrease in value. What goes up can come down. Recall that at the beginning of the 2000s the Euro had declined to an all time low against the U.S. dollar of 87 cents. This would suggest to the student that a forward exchange rate or hedging strategy should be considered.

139. (p. 305-308) If you agree to the payment strategy then two steps should be taken. The first is the establishment of the exchange rate that will be used. For example if a 60 forward exchange rate is used to protect the company against currency fluctuations then the exchange rate that the 60 day exchange rate is based upon should be the exchange rate listed in the contract.

140. (p. 302-304) The student should answer that increases in the value of the dollar can have two effects. The first is to increase the cost of Canadian goods, if you are charging in Canadian dollars. The second effect is to decrease your revenues and profits if as many Canadian manufacturers do, you charge in U.S. dollars. In either case this means less revenue or fewer sales, which in turn affects the strength of the Canadian company.

141. (p. 319-321) This answer requires some knowledge of current events and in particular what are the trends with respect to the U.S. trade deficit and the national deficit. This also requires the students to understand that the Canadian dollar, at least when so much of our trade is carried on with the Americans and our economy is tied to the health of the American economy, is heavily influenced by the rises and falls of the U.S. currency against other world currencies. This also requires some speculation as to the state of the commodities market and whether demand for commodities will remain high or not. Finally the student must think about inflation rates in Canada and whether the Bank of Canada is considering raising or lowering interest rates because of either the danger of the economy overheating or the danger of a slowdown.

Chapter 9 Summary

<u>Category</u>	<u># of Questions</u>
Difficulty: Easy	28
Difficulty: Hard	41
Difficulty: Medium	72
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