

Question #1 of 47

The carry trade is *most likely* to be profitable when:

- A) uncovered interest rate parity holds.
 - B) the Fisher relation is violated.
 - C) the forward rate is biased estimator of future spot rate.
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Question #2 of 47

Which of the following statements about foreign currency bid-ask spreads is *least* accurate?
Foreign currency bid-ask spreads:

- A) are influenced by time window in a trading day.
 - B) are a function of transaction volume and volatility.
 - C) increase as the size of the transaction decreases.
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Question #3 of 47

A bank in Canada is quoting CAD/USD 1.4950 – 1.5005, and USD/EUR 0.9350 – 0.9400. What is bid/ask exchange rate for CAD/EUR?

- A) CAD/EUR 1.5904 – 1.6048.
 - B) CAD/EUR 0.6254 – 0.6264.
 - C) CAD/EUR 1.3978 – 1.4105.
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Question #4 of 47

Which of the following is *least likely* a warning sign of an impending currency crisis?

- A) Money supply relative to bank reserves shrinks.

- B) Terms of trade deteriorate.
 - C) Liberalized capital markets that allow for a free flow of capital.
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Question #5 of 47

If the one-year forward exchange rate is DC/FC 2 and the spot rate is DC/FC 1.9 when the foreign rate of return is 12% and the domestic return is 10%, which of the following statements would be *most* accurate?

- A) The arbitrage possibilities cannot be determined with the data given.
 - B) Arbitrage is possible here, investors should borrow domestic, lend foreign.
 - C) Arbitrage is possible here, investors should borrow foreign, lend domestic.
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Question #6 of 47

One-year interest rates are 7.5% in the U.S. and 6.0% in New Zealand. The current spot exchange rate is USD/NZD 0.5500. If uncovered interest rate parity holds, the expected spot rate in one year must be *closest* to:

- A) USD/NZD 0.55825.
 - B) USD/NZD 0.54233.
 - C) USD/NZD 0.56675.
-

Question #7 of 47

Professor Imada Suzaken made the following statement to his economics class: "If you can earn 8% on A-rated bonds in the U.S. but only 6% on similar bonds in Canada, Canadian investors may want to buy those bonds in the U.S. for the excess return. However, after collecting the extra dollars, the investors would lose those profits when they converted their gains into their home currency." Suzaken's statement *most accurately* describes:

- A) purchasing-power parity.

- B)** covered interest rate parity.
- C)** uncovered interest-rate parity.

Jennifer Nance has recently been hired as an analyst at the Central City Bank in the currency trading department. Nance, who recently graduated with a degree in economics, will be working with other analysts to determine if there are profit opportunities in the foreign exchange market.

Nance has the following data available:

	US Dollar (\$)	UK Pound (£)	Euro(€)
Expected inflation rate	6.0%	3.0%	7.0%
One-year nominal interest rate	10.0%	6.0%	9.0%

Market Spot Rates			
	US Dollar (\$)	UK Pound (£)	Euro(€)
<i>US Dollar (\$)</i>	\$1.0000	\$1.6000	\$0.8000
<i>UK Pound (£)</i>	0.6250	1.0000	2.0000
<i>Euro (€)</i>	1.2500	0.5000	1.0000

Market 1-year Forward Rates			
	US Dollar (\$)	UK Pound (£)	Euro(€)
<i>US Dollar (\$)</i>	\$1.0000	\$1.6400	\$0.8082
<i>UK Pound (£)</i>	0.6098	1.0000	2.0292
<i>Euro (€)</i>	1.2373	0.4928	1.0000

Nance receives a report from Jamshed Banaji, Chief Economist at Central City Bank providing broad U.K and U.S. macro-economic forecasts. Nance notes that the Bank of England is expected to pursue an expansionary monetary policy while the Federal Reserve monetary policy is expected to be neutral. Also, the British parliament is expected to reduce the budget deficits more aggressively as compared to the U.S.

Question #8 of 47

Assume borrowing and lending rates are equal and bid-ask spreads are zero in the spot and forward markets. Using the data above, Nance is asked to calculate the profits in pounds from covered interest arbitrage between the United Kingdom and the United States, assuming an investor starts by borrowing £500,000. The answer is:

- A) £6,750.00.
 - B) £36,585.37.
 - C) £6,585.37.
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Question #9 of 47

The no-arbitrage one-year forward USD/EUR rate is *closest* to:

- A) USD/EUR 0.7925.
 - B) USD/EUR 0.8082.
 - C) USD/EUR 0.8073.
-

Question #10 of 47

For this question only, assume that the United States has a current account surplus versus the U.K. The amount by which the £/\$ has to change to restore current account balance is *least likely* to depend on:

- A) the projected current account deficit.
 - B) the initial level of current account surplus.
 - C) the response of import and export demand to changes in export prices.
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Question #11 of 47

Assuming high capital mobility in the U.K. and the U.S., according to the Mundell Fleming model, the £/\$ is *most likely* expected to:

- A) decrease.
 - B) increase.
 - C) remain unchanged.
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Question #12 of 47

For an investor pursuing a carry-trade, the funding currency would *most likely* be the:

- A) Euro.
 - B) Pound.
 - C) U.S. Dollar.
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Question #13 of 47

Which of the following is *least likely* to be a warning sign for currency crisis?

- A) Real exchange rate substantially lower than mean reverting level.
 - B) Inflation increases.
 - C) Nominal credit relative to bank reserves increase.
-

Question #14 of 47

An investor has entered into a 90-day forward contract to purchase 2 million GBP at an all-in rate of USD 1.4612. In 30 days, the following quotes were available:

	USD/GBP
spot rate	1.4522–24
30-day forward rate	1.4618–21
60-day forward rate	1.4621–25
90-day forward rate	1.4632–36

Interest rate information:

Interest rates	When contract was initiated		Currently (t=30)	
	USD	GBP	USD	GBP
30-day	0.20%	0.32%	0.20%	0.32%
60-day	0.21%	0.32%	0.21%	0.32%
90-day	0.21%	0.33%	0.21%	0.33%

The mark-to-market value of the forward contract is *closest* to:

- A) USD 1999
- B) USD 1800
- C) USD 2599

Question #15 of 47

Country P has high capital mobility and has recently switched from balanced fiscal policy to an expansionary fiscal policy. Over time this expansionary is expected to lead to an increase in government debt to GDP ratio.

If we simultaneously consider both the Mundell-Fleming and the portfolio balance model, in the long run country P's currency is *most likely* to:

- A) remain stable.
- B) appreciate.
- C) depreciate.

Question #16 of 47

Which of the following statements regarding purchasing power parity (PPP) is *least* accurate?

- A) Relative PPP states that prices for goods and services are the same whether it is for one good or for a basket of goods.
- B) Under absolute PPP the foreign price level expressed in domestic currency terms should be equal to the domestic country's price level.
- C) Absolute PPP is similar to the law of one price, except it concerns a basket of goods rather than a single good.

Question #17 of 47

Donna Ackerman, CFA, is an analyst in the currency trading department at State Bank. Ackerman is training a new hire, Fred Bos, a recent college graduate with a BA in economics.

Ackerman and Bos have the following information available to them:

Spot Rates		
	Bid Price	Ask Price
EUR/USD	€1.0000	€1.0015
GBP/USD	£2.0000	£2.0100
EUR/GBP	€0.3985	€0.4000

Ackerman and Bos are interested in pursuing profitable arbitrage opportunities for State Bank. What will be the profits from triangular arbitrage, starting with \$1,000?

- A) \$245.65.
- B) \$248.46.
- C) \$243.78.

Question #18 of 47

Which of the following is *least likely* a warning sign of an impending currency crisis?

- A) Floating exchange rates
- B) Currency value is substantially higher than the mean-reverting level.
- C) Official foreign exchange reserves decline dramatically.

Question #19 of 47

The following information is gathered for three countries:

Country	Comment
A	Current account deficit is very large relative to GDP
B	Imports highly price-elastic goods
C	Exports global commodities

Which country will *most likely* see its current account deficit restored to sustainable level more rapidly under the flows mechanism of balance of payments?

- A) Country C
- B) Country A
- C) Country B

Patrick Sheehan is the head of foreign currency desk at GPN Bank NA, a large U.S. Bank holding company. Patrick is concerned about recent spike in volatility of EUR. He obtains current spot and forward quotes from his terminal (given in Exhibit 1). He also collects interest rate information (given in Exhibit 2).

Exhibit 1: Current spot and forward exchange rate quotes

Currency Paid	Spot rates	Forward rates		
		30-day	60-day	90-day
USD/EUR	1.3110–14	+3.18/+3.38	+6.73/+7.18	+10.48/+10.78
CHF/USD	0.9273–77	–4.09/–3.79	–8.45/–7.95	–12.80/–12.05

USD/GBP	1.6242-47	-26.10/-24.6	-50.20/-47.20	-72.20/-68.2
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Exhibit 2: Selected interest rates

Interest Rates	USD	EUR	CHF	INR
30 day	0.21%	0.90%	1.12%	6.72%
60 day	0.22%	0.93%	1.15%	6.84%
90 day	0.25%	1.04%	1.25%	6.90%

Sheehan reviews bank's current open forward contracts. One of the contracts calls for purchase of EUR 200 million at an all-in rate of USD 1.3912 and matures in 30 days.

During the market turmoil of late 2008, GPN had lost a lot of money in FX carry trades. Sheehan realizes that GPN has not established any new FX carry trade positions since then and is anxious to establish new positions. One trade that he finds promising is a carry trade in Indian Rupee (INR). Sheehan notes that while the spot rate is 53.88 INR/USD, Melissa Andrews, GPN's Chief Economist expects the Rupee to trade at 54.12 INR/USD in 90 days.

During his conversation with Andrews, Sheehan asks about the driving factor behind depreciation of the Rupee in the recent past. Andrews explains that there are several theories to explain exchange rate movements. Personally, she prefers to focus on the long-term implications of fiscal policy. She feels that the interest rate in India is expected to be higher than in the U.S. She also states that India is following a more expansionary fiscal policy as compared to the U.S. and that policy is expected to continue. Sheehan observes that such deficits have resulted in large external debt relative to GDP for India.

Sheehan observes that over the past decade, capital controls in India have been loosened resulting in free flow of capital. Additionally, due to a relatively more restrictive monetary policy in India relative to the U.S., nominal interest rates have been substantially higher in India as compared to the U.S.

Question #20 of 47

The most likely candidate for funding currency in the carry trade contemplated by Sheehan and the potential return on the carry trade is closest to:

<u>Funding currency.</u>	<u>Expected return</u>
A) INR	6.95%

- B) USD 6.65%
- C) USD 1.25%
-

Question #21 of 47

The current mark-to-market value of the EUR forward contract is *closest* to:

- A) -USD 15,973,205.
- B) -USD 15,889,620.
- C) -USD 15,976,000.
-

Question #22 of 47

Regarding the valuation of INR, Andrews would *most likely* use:

- A) Mundell-Fleming model
- B) Portfolio Balance Approach
- C) Monetary approach
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Question #23 of 47

Based on Andrew's projections, under the capital account influences of the balance of payments, INR/USD would *most likely*:

- A) decrease.
- B) increase.
- C) remain unchanged.
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Question #24 of 47

Based on the Mundell-Fleming model, relative to the USD, the INR would *most likely*?

- A) depreciate.
 - B) appreciate or depreciate.
 - C) appreciate.
-

Question #25 of 47

Under the asset market approach to exchange rate determination, relative to USD, INR would *most likely*.

- A) depreciate in the long-term.
 - B) appreciate in the long-term.
 - C) appreciate in the short-term.
-

Question #26 of 47

Ninety days ago, Marc Samuelson entered into a 180-day forward contract to purchase 1 million CHF at an all-in rate of \$1.0225/CHF.

The following USD/CHF quotes are currently available in the market:

Spot	1.0301/1.0302
30 days	1.033613
90 days	1.081081
180 days	1.061798

Interest rates:

90-day CHF	1.02%
180-day CHF	1.03%
90-day USD	1.00%
180-day USD	0.99%

The mark-to-market value of Samuelson's position is *closest* to:

- A) \$5,985
- B) \$7,585
- C) -\$6,735

Question #27 of 47

Given spot exchange rate of CAD/EUR 1.425-1.435, The spread is *closest* to:

- A) CAD 0.0010
- B) 10 pips EUR
- C) CAD 0.010

Question #28 of 47

Under the Mundell-Fleming model and the asset market approach to exchange rate determination, a country following sustained expansionary fiscal policy would see its currency:

- A) appreciate in the short-run and appreciate in the long-run.
 - B) appreciate in the short-run and depreciate in the long-run.
 - C) depreciate in the short-run and depreciate in the long-run.
-

Question #29 of 47

Assume that the domestic nominal rate of return is 4% and the foreign nominal rate of return is 5%. If the current exchange rate is DC/FC 0.400, the forward rate consistent with covered interest rate parity is:

- A) 0.318.
 - B) 0.396.
 - C) 0.400.
-

Question #30 of 47

Given the following quotes for the Canadian dollar (CAD) and the British pound (GBP), the implied CAD/GBP bid-ask quotes are *closest* to:

CAD/USD 1.59031 – 1.59701

GBP/USD 0.69459 – 0.69686

- A) CAD/GBP 2.2992 – 2.3163.
 - B) CAD/GBP 2.2895 – 3.2886.
 - C) CAD/GBP 2.2821 – 2.2992.
-

Question #31 of 47

Which of the following is *least likely* the objective of central bank intervention?

- A) prevent appreciation of domestic currency
 - B) have ability to pursue an independent monetary policy
 - C) reduce excessive inflow of foreign capital
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Question #32 of 47

Zimbaya is a developed economy with high capital mobility. Deborah Isaccson is evaluating the Zim (Z\$), the national currency of Zimbaya. Which of the following is *most likely* to lead to appreciation of Z\$? If Zimbaya starts following:

- A) a loose monetary policy.
 - B) a restrictive fiscal policy.
 - C) an expansionary fiscal policy.
-

Question #33 of 47

Terrance Burnhart, a junior analyst at Wertheim Investments Inc., was discussing the concepts of purchasing power parity (PPP) and uncovered interest rate parity (UIRP) with his colleague, Francis Ferngood. During the conversation Burnhart made the following statements:

- Statement 1: Absolute PPP is based on a number of unrealistic assumptions that limits its real-world usefulness. These assumptions are: that all goods and services can be transported among countries at no cost; and all countries use the same basket of goods and services to measure their price levels.
- Statement 2: UIRP rests on the idea of equal real interest rates across international borders. Real interest rate differentials would result in capital flows to the higher real interest rate country, equalizing the rates over time. Another way to say this is that differences in interest rates are equal to differences in expected changes in exchange rates.

With respect to these statements:

- A) only statement 2 is correct.

- B) only statement 1 is correct.
 - C) both are correct.
-

Question #34 of 47

The forward rate on a 90-day contract is FC/USD 5 and the spot is FC/USD 4. The USD is trading at a forward:

- A) discount of 1.0.
 - B) premium of 1.0.
 - C) premium of 0.8.
-

Question #35 of 47

The domestic interest rate is 9% and the foreign interest rate is 7%. If the forward exchange rate is DC/FC 5.00, what spot exchange rate is consistent with covered interest parity?

- A) 4.83.
 - B) 4.91.
 - C) 5.09.
-

Question #36 of 47

Given currency quotes in DC/FC, if: $1 + r_{DC} < (1 + r_{FC})$ (forward rate)/ spot rate funds will:

- A) flow out of the domestic country.
 - B) flow into the domestic country.
 - C) flow in and out of the domestic country.
-

Question #37 of 47

Ackerman explains to Bos that a theoretical relationship exists between forward rates and future spot rates, called the forward rate parity. This relation suggests that:

- A) the forward rate is an unbiased predictor of the expected future spot rate, and uncovered interest rate parity would hold.
 - B) the forward rate is a biased predictor of the expected future spot rate, and uncovered interest rate parity would not hold.
 - C) the forward rate is an unbiased predictor of the expected future spot rate, and uncovered interest rate parity would not hold.
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Question #38 of 47

Ashok Jain is assessing the currency value of Lutina. Jain believes that prices are sticky in the short term and, hence, do not immediately reflect changes in monetary policy. If Lutina announces a change to a restrictive monetary policy, Jain would *most likely* conclude that Lutina's currency would:

- A) excessively appreciate in the short-term.
 - B) excessively depreciate in the long-term.
 - C) excessively appreciate in the long-term.
-

Question #39 of 47

Under high capital mobility, the Mundell-Fleming model to determine exchange rate focuses on the impact of:

- A) trade balance.
 - B) inflation.
 - C) interest rates.
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Question #40 of 47

Assume an investor living in Japan can borrow in the domestic yen (JPY) or in the foreign U.S. dollar (USD). Given the following information, determine whether an arbitrage opportunity exists. If so, how much would the investor profit by borrowing JPY 58,175,000 or the equivalent in USD? (Assume a period of one year.)

Spot rate (JPY/USD)	116.35
Forward rate (JPY/USD)	112.99
Domestic (Japanese) interest rate (%)	1.50
Foreign (U.S.) interest rate (%)	4.00

- A) An arbitrage opportunity results in a profit of JPY 27,963.
 - B) An arbitrage opportunity results in a profit of JPY 25,170.
 - C) An arbitrage opportunity results in a profit of JPY 292,825.
-

Question #41 of 47

Tim Kramer is assessing the risks of the carry trade for his firm. He obtains a distribution of expected returns for the carry trade. This distribution is *most likely* to exhibit:

- A) fat tails and a positive skew.
 - B) a normal distribution.
 - C) fat tails and a negative skew.
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Question #42 of 47

Country P has high capital mobility and has recently switched from a balanced fiscal policy to an expansionary fiscal policy. Over time this expansionary fiscal policy is expected to lead to an increase in the government debt-to-GDP ratio.

If we simultaneously consider both the Mundell-Fleming and the portfolio balance model, in the short term country P's currency is *most likely* to:

- A) remain stable.
 - B) depreciate.
 - C) appreciate.
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Question #43 of 47

Assume an investor living in Mauritius can borrow in \$ or in Mauritius Rupee (MUR). Given the following information, determine whether an arbitrage opportunity exists. If so, how much would the arbitrageur profit by borrowing MUR 1,000,000 or the equivalent in \$? (Assume a period of one year and state the profit in domestic currency terms.)

Spot rate (MUR/\$)	30.73000
Forward rate (MUR/\$)	31.50000
Domestic (MUR) interest rate (%)	6.50%
Foreign (\$) interest rate (%)	5.20%

Which of the following is *closest* to the correct answer?

- A) Borrow \$. Arbitrage profits are \$13,340.
 - B) Borrow MUR. Arbitrage profits are MUR 13,340.
 - C) Borrow domestic. Arbitrage profits are \$39,685.
-

Question #44 of 47

Today, the spot rate on pounds sterling is \$0.6960 and 90-day forward pounds are priced at \$0.6925. The forward discount/premium is:

- A) premium of \$0.0005
 - B) discount of \$0.0035
 - C) premium of \$0.0035
-

Question #45 of 47

The return distribution of FX carry trade is characterized by:

- A) positive skewness and positive excess kurtosis.
 - B) negative skewness and positive excess kurtosis.
 - C) negative skewness and negative excess kurtosis.
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Question #46 of 47

Given the following information, what is the forward exchange rate implied by interest rate parity?

- U.S. interest rate = 9%.
- North Korea interest rate = 10%.
- Spot rate = 1.65 KPW/\$.

- A) 1.635 KPW/\$.
 - B) 0.612 KPW/\$.
 - C) 1.665 KPW/\$.
-

Question #47 of 47

Which of the following statements regarding relative purchasing power parity is *most* accurate?

Relative purchasing power states that exchange rates:

- A) will change to reflect differences in inflation between countries.
- B) will change to reflect differences in nominal interest rates between countries.
- C) will change to reflect differences in real interest rates between countries.