

Economics 345  
Practice mid-term Examination

This practice exam is longer than the actual examination but different questions and formats have been included to give you a sense of the possible questions. The actual midterm may be worth about 90 points and may last as long as 90 minutes. The number of points each question is worth will tell you about how much time I expect you to spend on it. Answers to be discussed in tutorial.

I. (2 points each) Define and briefly explain five of the following terms: official settlements balance, arbitrage, the real exchange rate, open interest parity, relative purchasing power parity, the J-curve, uncovered interest rate parity

II. Answer the following questions True, False or Uncertain and briefly explain your answer. Each question is worth 10 points.

1. There is a positive relationship between the exchange rate and the expected dollar return on foreign assets.
2. There is a one-time increase in the domestic money supply. We do not expect to see exchange rate overshooting.
3. The effect of a transitory increase in fiscal policy spending is to improve the current account and to raise output and prices and the exchange rate in roughly equal proportions.
4. Initially there is a 10 percent per year inflation and 2 percent real income growth. The money supply growth rate increases to 16 percent per year. We expect price growth to increase gradually, and the exchange rate to depreciate gradually, until both are increasing at 6 percent per year in the long run.
5. Monetary policy is effective in a floating exchange rate regime.
6. Fiscal policy is effective in a floating exchange rate regime.
7. A depreciation of the real exchange rate increases net exports.
8. According to Balassa-Samulson theory of real exchange rates, productivity increases in tradeables will depreciate the exchange rate.
9. Uncovered interest parity together with covered interest parity means that the forward rate equals the expected future spot rate.

III. Choose the correct answer. (2 points each)

1. If the dollar interest rate is 10 percent, the euro interest rate is 6 percent, and the dollar depreciation against the euro is 4 percent, then
  - a. An investor should invest only in dollars
  - b. An investor should invest only in euros
  - c. An investor should be indifferent between investments in dollars or euros
  - d. It is impossible to tell given the information.
2. If we think of Irving Fisher's theory that writes  $MV=PT$ , the role of money emphasized is:

- a. A medium of exchange
- b. A store of value
- c. A unit of account
- d. A and C
- e. None of the above

Answers to be given in tutorial next week.