

## Homework 2

Due: One hour before class on Monday, February 1, 2010.

### Q1. [Past Exam Question]

Compare **and** contrast the overall Balance of Payments under fixed and pure floating exchange rates.

Q2) [Past Exam Question] You are offered the following direct bid and ask rates from three banks

<b>Bank</b>	<b>Exchange Rate</b>	<b>Bid</b>	<b>Ask</b>
Bank of America	S(\$/£)	1.7452	1.7459
Deutsche Bank	S(€/£)	0.7829	0.7835
Barclay's	S(£/€)	0.6953	0.6960

A) How can an American investor generate arbitrage profits if she is able to borrow up to one million US dollars? Clearly explain your methodology and your reasons for choosing particular exchange rates. [12 marks]

B) What economic forces will correct this problem? Be specific, and include numbers in your answer.

### Q3) Textbook Questions

Chapter 3 Q5, Q10

Chapter 5: Q6, P.6, P.13★

Chapter 6: P.1

★: Requires a bit of thought.