SIMON FRASER UNIVERSITY
Department of Economics

Econ 345 | Prof. Kasa
International Finance | Spring 2016

PROBLEM SET 1
(Due February 4)

1. (10 points). The USA is a net debtor vis-a-vis the rest of the world. At the same time, it has recently had positive net factor payments in its current account. How could this be? Why might this be relevant for the dynamics of current account adjustment?

2. (10 points). Suppose the 12-month forward price of the euro in terms of C$ is 2.0 C$ per euro. Suppose the spot price of of the euro in terms of C$ is 1.8. Next, suppose that currently the annual interest rate in Canada is 6%, while the annual euro interest rate is 4%. There are no transactions costs. Is there an arbitrage opportunity here? If so, explain exactly how you would take advantage of this situation to make riskless profits.

3. (15 points). Read the article entitled "Fight or Flight" from *The Economist*, which is posted on the course webpage. What has been happening recently to China's foreign reserves? According to the article, how should China respond? What are the potential downsides to this strategy?

4. (15 points). The Canadian dollar has been depreciating recently. At the same time, the Bank of Canada has been cutting its interest rate, while the US Fed has been raising its interest rate. Given this, under what conditions could Uncovered Interest Parity help explain the recent weakness of the Canadian dollar. Use graphs to illustrate your answer.