SIMON FRASER UNIVERSITY
Department of Economics

Econ 345
International Finance

Prof. Kasa
Fall 2017

PROBLEM SET 1
(Due October 5)

1. (25 points). Suppose the 12-month forward price of the British pound in terms of dollars is 1.5 dollars per pound. Suppose the spot price of of the pound in terms of dollars is 1.45. Next, suppose that currently the annual interest rate on dollar deposits is 3%, while the interest rate on a comparable pound deposit is 2%. 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.

2. (25 points). Recently, the Canadian dollar has appreciated against the US dollar. Use our model of simultaneous equilibrium in the foreign exchange and domestic asset markets to provide three reasons why this might have happened. Be sure to distinguish between Canadian and US economic developments. Also, illustrate your answers using a graph.

   What additional evidence would you look at to figure out which is the most likely explanation?