SIMON FRASER UNIVERSITY
Department of Economics

Econ 345 | Prof. Kasa
International Finance | Spring 2020

PROBLEM SET 1
(Due February 5)

1. (25 points). Suppose the 12-month forward price of the pound in terms of dollars is 1.5 dollars per pound. Suppose the spot price of of the pound in terms of dollars is 1.55. Next, suppose that currently the annual interest rate on dollar deposits is 2%, while the interest rate on a comparable pound deposit 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.

2. (25 points). Read the article entitled "China, New Financial Superpower", by Brad Setser, which is posted on the class webpage. Setser points out that China is now the world's largest creditor country. Historically, the currency of the world's largest creditor becomes the world's reserve currency, e.g., Britain in the 1800s and the USA in the 1900s. This hasn't happened yet in the case of China. According to Setser, why hasn't China's currency become more internationalized? Describe three differences between China currently and the examples of Britain in the 1800s and America in the 1900s?