SIMON FRASER UNIVERSITY
Department of Economics

Econ 446   Prof. Kasa
Seminar in International Finance   Spring 2018

MIDTERM EXAM
(February 7)

Answer the following questions True, False, or Uncertain. Briefly explain your answers. No credit
without explanation. (10 points each).

1. If the foreign exchange market is efficient, exchange rates follow random walks.

2. The Balassa-Samuelson theory of real exchange rate determination is not applicable in countries like China, which fix their exchange rates.

3. Temporary changes in a country's terms of trade produce stronger effects on the current account than permanent changes in the terms of trade.

4. A country cannot have a negative net foreign asset position (like the USA), and at the same time have a positive net factor income balance in the current account.

   The following questions are short answer. Briefly explain your answer. Clarity will be rewarded.

5. (30 points). For most countries, current accounts are countercyclical (i.e., when $Y \uparrow \Rightarrow CA \downarrow$). This seems to contradict the simple consumption-smoothing model of the current that we discussed in class. Explain how this model can be extended so that the current account becomes countercyclical.

6. (30 points). What is the Forward Premium puzzle (or Uncovered Interest Parity puzzle)? On what evidence is it based? Briefly discuss a couple of possible resolutions of this puzzle.