

SIMON FRASER UNIVERSITY  
Department of Economics

Econ 842  
International Monetary Economics

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MIDTERM EXAM

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

1. Empirically, it is difficult to reject the hypothesis that exchange rates follow random walks. Therefore, we can conclude the foreign exchange market is efficient (i.e., you cannot make 'excess profits' from trading in foreign exchange).
2. A country cannot run current account deficits forever. Eventually the current account must balance.
3. An improvement in a country's terms of trade causes a current account surplus.
4. According to the Balassa-Samuelson theory, rapid productivity growth causes the real exchange rate to appreciate.

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

5. (30 points). What is the Feldstein-Horioka puzzle? On what evidence is it based? Briefly discuss a couple of possible resolutions of this puzzle.
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.