

Place your name on the back of this sheet of paper and nowhere else. Staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (10 points) Suppose that today the exchange rate was \$1.5/£ and later this month it will change to £0.5/\$. Did the dollar appreciate, depreciate, revalue, or devalue? Explain your logic and show any appropriate calculations.
- 2) (10 points) Suppose you are a foreign student from Germany and you knew your tuition for next semester would be \$30,000. And would be due July 1. What could you do to reduce the risk that the exchange rate would change? Explain how that would reduce your risk.
- 3) (10 points) When we write $S_{US/J}$ or $F_{US/J}$, do we write it as \$/¥ or ¥/\$. Is that the price of a dollar or the price of a yen? Explain your logic.
- 4) (20 points) What is meant by PPP? Explain why it should hold. What does it imply about relative inflation rates? Explain your logic.
- 5) (20 points) What is meant by interest rate parity? Why should it hold? If the current nominal interest rate in the US was 4% and in Germany was 5%, and the current spot exchange rate is \$1/€, then what should the one-year forward rate be? Show all work.
- 6) (20 points) In farming communities, they regularly announce the price of commodity futures like corn futures. What does that mean? Why would a farmer want to participate in that market?
- 7) (10 points) Why don't farmers put their whole expected crop for sale on the futures market?