

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type this assignment 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) Right now, the exchange rate between the \$ and the ¥ is about ¥110/\$ and the exchange rate between the £ and the ¥ is about ¥132/£. What is the exchange rate in \$/£? What is the exchange rate in £/\$? Show all work and state how you know which number was which exchange rate.

2) (15 points each) I have a student from Greece. He knows he will be paying Bethany College \$10,000 in three months. Explain how he could reduce risk using the method mentioned. Describe what he would do now and what he would do in three months. Explain how it reduces his risk.

- A) the forward market.
- B) the options market with a call option.
- C) the options market with a put option.

3) (20 points) Draw the diagram for covered interest arbitrage parity. Explain why the CIAP line is upward sloping. Why is there a gap on both sides of it? Why is the upper left labeled inflow?

4) (15 points) Explain why people might prefer foreign exchange futures over the forward market.

5) (10 points) What is a eurodollar account? Why would somebody want one?

Of interest, the term eurodollar and eurocurrency go back decades before the euro was thought of. I have wondered what you call a bank account in euros which is in a non-european country? Logic would imply it is a euroeuro account, but that name seems stupid.