Wilfrid W. Csaplar Jr. International Trade Review Sheet for Exam 3 and the Final

This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be at a time to be determined in class, probably Monday 4/25.

Chapter 10: What are **free trade areas (FTA), customs unions (CU), common markets,** and **economic unions**? Why are the differences important? Be able to show **trade creation** and **trade diversion** on the supply and demand for an import. Understand why each of the six items in the list of properties which increase the probability of gains in welfare are likely to increase welfare of the country. Understand the benefits of FTA and/or CU. They include **more bargaining power, less resistence to free trade** (my belief)**, more competition, greater economies of scale,** and **tariff factories.** Know what the following are: **EU, NAFTA,** and **Mercosur**. Ignore all other FTA, CU, etc.

***For Chapters 13 - 16, you can find old test questions by looking at Test #1 & #2 from ECON 365.***

Chapter 13: Know what **debits** and **credits** are. Be able to do the **double entry bookkeeping for exports of goods, imports of goods, exports of services, imports of services, sales of assets abroad, purchases of foreign assets,** and **unilateral transfers**. If I gave you a table like **Table 13.1**, be able to calculate the items in the **memoranda**. Know why the **current and capital accounts** should add to zero. What is the **international investment position**? Why does it matter?

Chapter 14: Be able to tell if an exchange rate **appreciated, depreciated, revalued,** or **devalued.** *The former two are for flexible exchange rates, the latter two are for fixed exchange rates.* Be able to manipulate the **supply/demand diagram for foreign exchange.** *Note that the currency on the horizontal axis is the one being supplied or demanded, so on the vertical axis, it is underneath the other currency. Remember why somebody would demand a currency or supply it. Since the demand for one currency is the supply of the other and most events affect both countries similarly, most events move both lines.* Be able to do **three point arbitrage.** What are **spot** and **forward exchange rates**? Be able to calculate the **forward discount** or **forward premium** and know what they mean. What are the following and how can you use them to reduce exchange rate risk? **Foreign exchange swaps, foreign exchange futures,** and **foreign exchange options.** What is meant by **hedging, long position, short position,** and **speculating**? What are **covered interest arbitrage** and **covered interest arbitrage parity**? Understand why the **diagram on Page 448** for **CIAP** has the band and why below the band is outflow and above it is inflow. Understand the second equation for **CIAM** (14-2) and why it holds. *Note that for the CIAM, the first term is how much more we get <u>at home</u> by having our bonds and we subtract the FP which is what we would gain from the exchange rate if we put the money abroad.* What is meant by **eurocurrency**? (Would a euro denominated account in the US be a euroero account?) What are **eurobonds**?

Chapter15: What are **absolute PPP** and **relative PPP**? Because I changed R to be £/$ the latter becomes

$R_1 = \dfrac{P_1^* / P_0^*}{P_1 / P_0} R_0$ Why should they hold? What are problems with them? What is the **monetary approach to the exchange rate**? (*That is using MV=PY.*) Why would it explain the exchange rate? What is the **asset market approach**? (*That is the equation to the right*) and the similar equations for **D & F** which are the demand for domestic and foreign bonds respectively. Be able to explain the economics behind the signs in the three equations like . Understand why panels b through d in **Figure 15.6** behave like that given panel a as given. Why did I turn the last panel up-side-down?

$$M = f(\overset{-}{i}, \overset{-}{i}^*, \overset{-}{EA}{}^*, R\overset{+}{P}{}^*, \overset{+}{Y}, \overset{+}{P}, \overset{+}{W})$$

Chapter 16 up until we covered: Understand how the **balance of payments adjusts with flexible exchange rates**. *That is showing the BOP on the S/D for currency.* Know how to **derive the supply and demand for foreign exchange** from the supply and demand for imports and exports. *Note that the demand for imported goods will result in a demand of the other country's currency and a supply of the home currency.* How do exchange rate changes affect the domestic income and prices? What is the **Dutch Disease**? *We are not talking about elms. It is where your economy grows so much that the terms of trade turn against your exports and your economy is hurt.* Be able to tell if the **exchange rate will be stable or unstable** by looking at a **graph** and with the **Marshall-Lerner condition**. Understand the economics of why Marshall-Lerner condition holds. What is meant by the identification problem. What is the **J-curve** and how can the Marshall-Lerner condition be used to explain it? How do the economies adjust to improperly set exchange rates under the **gold standard**? Ignore the appendix; however, Section A16.3 may help you to understand part of the chapter better.

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Non-graded Assignment #9A to be reviewed with Homework #9.

1) (10 points) What the reason that you would expect relative PPP to hold? Explain your logic.

2) (10 points) We said that the demand form money increases and the demand for foreign bonds decreases when RP* increases. Why are those statements true?

3) (10 points) We said that the demand form money increases and the demand for domestic bonds decreases when r decreases. Why are those statements true?

4) (10 points) We said that the demand form domestic bonds increases and the demand for foreign bonds decreases when EA* increases. Why are those statements true?

5) (20 points) I redrew the graph on Page 423 which shows the exchange rate over time when the money supply suddenly increases. I drew it with €/$ on the axis. Draw it the way I drew it and explain why it takes that shape.

6) (25 points) Draw the supply/demand for currency such that the exchange rate is unstable. Prove it is unstable.

7) (15 points) State the Marshal-Lerner condition and explain why it makes sense.

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**Review Sheet for the Final**

The final will be Tuesday 5/3 at 3:00 unless you want the time changed. The review session will be the day of your choice, probably 5/2. The material will be fairly evenly split between the material on the three exams.