

- _____ 1. Regression tests of the uncovered interest parity hypothesis indicate that the forward premium _____.
- is an unbiased indicator of expected future exchange rate changes
 - is approximately equal to the interest rate differential
 - does not provide an unbiased predictor of future exchange rate changes**
 - has a strong correlation to the current account
- _____ 2. Which of these is *not* a possible interpretation of the empirical failure of the forward-rate unbiasedness hypothesis?
- There is a foreign exchange risk premium.
 - Expectations are not rational.
 - Peso problems plague the tests.
 - Uncovered interest rate parity holds.**
- _____ 3. Suppose the dollar interest rate in the U.S. is $i_t^{\$}$ and the sterling interest rate in the U.K. is i_t^{\pounds} . $S_t^{\$/\pounds}$ is the dollar/sterling spot exchange rate and $F_t^{\$/\pounds}$ is the dollar/sterling forward rate. If one were following the “carry trade” investment strategy, one would borrow dollars and invest in sterling if
- $i_t^{\$} < i_t^{\pounds}$
 - $i_t^{\$} > i_t^{\pounds}$
 - $\frac{E_t S_{t+1}^{\$/\pounds} - S_t^{\$/\pounds}}{S_t^{\$/\pounds}} > \frac{i_t^{\$} - i_t^{\pounds}}{1 + i_t^{\pounds}}$
 - $\frac{E_t S_{t+1}^{\$/\pounds} - S_t^{\$/\pounds}}{S_t^{\$/\pounds}} < \frac{i_t^{\$} - i_t^{\pounds}}{1 + i_t^{\pounds}}$
- _____ 4. In tests of the unbiasedness hypothesis in which the *ex post* rate of change of the exchange rate is regressed on the forward premium, the slope coefficient
- tends to be close to one in the data, as in the unbiasedness hypothesis.
 - tends to be negative in the data, while in the unbiasedness hypothesis it should be one.**
 - tends to be one in the data, while in the unbiasedness hypothesis it should be negative.
 - tends to be negative in the data, as in the unbiasedness hypothesis.

- _____ 5. The version of purchasing power parity that states the exchange rates will adjust to equalize the internal and external purchasing power of a currency is known as _____.
- Relative purchasing power parity
 - Equilibrium purchasing power parity
 - Absolute purchasing power parity***
 - Real exchange rate equilibrium
- _____ 6. When the price of one commodity is the same wherever in the world the good is being sold when denominated in a particular currency, it is said the Law of _____ prevails.
- Currency supply
 - Currency demand
 - Purchasing power parity
 - One Price***
- _____ 7. When the external purchasing power of a currency is greater than the internal purchasing power, the currency is said to be _____.
- overvalued***
 - undervalued
 - at parity
 - in arbitrage
- _____ 8. The theory of relative purchasing power parity states that, between two nations, the
- inflation rates are unrelated
 - exchange rate change reflects the inflation rate differential***
 - inflation rate is smaller in weaker currencies
 - the interest rate is greater than the inflation rate during depreciations
- _____ 9. Which of the following is ***least*** likely to cause the prices of goods and services deviate from the law of one price?
- Sticky prices
 - Pricing to market
 - Tariffs and Quotas
 - Capital controls***