Instructions: Answer all parts of all questions as concisely as possible.

Due Date: Thursday April 27th, 5.00 p.m.
Total points: 100

Question 1. True/False: International Money Markets (40 points)

For this question, write no more than one paragraph for each question. Is each of the following statements true or false? *Explain your answer carefully.*

i) From an initial covered investment equilibrium, an increase in the supply of currency in a country tends to reduce the domestic interest rate and so produce temporary capital outflows.

ii) From an initial uncovered investment equilibrium, a rise in government spending which tends to raise the domestic interest rate will produce temporary capital outflows.

iii) If a risk averse US investor believes that purchasing power parity holds between the US and Japan, then the expected real interest differential between the US and Japan will be irrelevant to her investment decision.

iv) If uncovered foreign investments raise the overall riskiness of a domestic investor's portfolio, then the forward rate will tend to be lower than the expected future spot rate.

v) If the covariance of two countries' inflation rates is positive, then risk averse investors will tend to set the forward rate above the expected future spot rate.

Question 2. Exchange Rates and Output Determination. (60 points)

Answer questions #1, #2, #3, #4 and #5 at the end of Chapter 13.