ECON 133 – Securities Markets – Fall 2010
Practice Problems – Foreign Exchange

1. Which of the following currency movements can be described as dollar appreciation? Note, ¥ denotes Japanese yen and CA$ denotes Canadian dollar.

   a. From ¥100/$ to ¥110/$
   b. From ¥110/$ to ¥100/$
   c. From $0.7/CA$ to $0.8/CA$
   d. From CA$1.5/$ to CA$1.4/$

2. Uncovered Interest Parity – The annual interest rate on the euro zone is 10% and 5% in the U.S. Suppose the exchange rate is currently at 1.25 dollar per euro. Calculate the expected exchange rate one year from now, assuming the uncovered interest rate parity holds.

3. Covered Interest Parity – The risk-free interest rate in the US is 4% while the risk-free interest rate in the UK is 9%. If the British pound is worth $2.00 in the spot market, a 1-year futures rate on the British pound should be worth __________.
   A. $1.83
   B. $1.91
   C. $2.08
   D. $2.18

4. One year U.S. interest rates are 5% and European interest rates are 7%. The spot euro direct exchange rate quote is 1.32 and the one year forward rate direct quote is 1.35. If you have $1 million dollars or € 1 million to start with what would be your dollar profit from an interest arbitrage based on this data? Describe the steps to obtaining this profit.