

ECON 101, Sen Finance Quiz 4
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Ques 1 I) An increase in production opportunities that promise higher returns (than existing production opportunities) would push down interest rates.

II) A nominal rate of return of 7% is ALWAYS better than a real rate of return of 3%.

I&II are: A) TT B) TF C) FT D) FF

Ques 2) I) The imposition of tariffs or import quotas pushes out the supply schedule to the right lowering prices for consumers.

II) For producers exports push out the demand schedule for their products to the right, enabling them to obtain higher prices.

I&II are: A) TT B) TF C) FT D) FF

Ques 3) I) Auction markets have the price determined by prospective buyers bidding against each other.

II) For securities issued by firms, the Primary Markets are the ones in which they sell directly to investors.

I&II are: A) TT B) TF C) FT D) FF

Ques 4) I) Futures markets have agreements that require payment and delivery at a future date for sale of an asset at a price that will prevail in the market at the future date.

II) In a Spot market, the delivery of the good is required immediately or within a short period of time.

I&II are: A) TT B) TF C) FT D) FF

Ques 5) I) NYSE and NASDAQ are the major US stock exchanges.

II) NASDAQ has a physical location.

I&II are: A) TT B) TF C) FT D) FF

Information for 6 to 9: Suppose India and the Nepal do not trade. In this situation of no-trade India it requires 80 units of labor to produce a car and 4 units of labor to produce a computer, whereas in the Nepal it requires 160 units and 32 units respectively.

Ques 6: I) India has a comparative advantage in producing cars.

II) Nepal has an absolute advantage in producing cars and India has an absolute advantage in producing computers.

I&II are: A) TT B) TF C) FT D) FF

Information for Questions 7 and 8: Now suppose the India and Nepal remove trade barriers and begin trading.

Ques 7) I) We would expect to see the India produce more computers.

**II) We would expect to see labor in Nepal move from producing cars to computers.
I&II are: A) TT B) TF C) FT D) FF**

Ques 8) I) We would expect to see increased production of cars in Nepal and decreased production of cars in India.

II) We would expect to see total production of either more cars or more computers (but NOT BOTH cars and computers) depending upon consumer preferences of the larger economy (India).

I&II are: A) TT B) TF C) FT D) FF

Ques 9) I) Firms raise short term debt in Money Markets.

II) Firms raise long term debt and equity in the Capital Markets.

I&II are: A) TT B) TF C) FT D) FF

Ques 10) I) NASDAQ has no market specialists to buy unfilled orders.

II) The NASDAQ is a dealer market.

I&II are: A) TT B) TF C) FT D) FF

Information for Questions ?? to ??: Suppose the current Euro-Dollar exchange rate is Euro 0.80 to \$1. The riskless rate in the US is $r_{\$} = 6\%$ per annum and in Germany is $r_{\text{Euro}} = 1\%$ per annum. F is the futures exchange rate (which is the rate at which you can contract today to exchange Deutsche Marks for Dollars one year later in the futures market) and S is the Spot Exchange rate (the rate at which you can exchange Deutsche Marks for Dollars today). Assume traders can both borrow and lend at the riskless rates.

Question: What is the futures exchange rate for converting Euros to Dollars according to the covered interest parity relation?

Question: If you find that the prevailing futures rate in the market is Euro 0.79 to \$1. Define arbitrage profit as a net positive cash flow today, and net zero cash flow for sure in the future.

I) Arbitrage profit actions include entering a futures contract in which the trader will pay Euros and receive Dollars.

II) Arbitrage profit actions include selling Dollar bonds today (borrowing at the riskless Dollar rate).

Question: I) Arbitrage profit actions include selling Euro bonds today (borrowing at the riskless Euro rate).

II) To cancel a negative cash flow in a particular currency due to a futures contract requires the purchase of bonds in the same currency today.

In generating the arbitrage profits, suppose the trader has entered into a contract that requires him to either give or receive \$1M for Euro 790,000. What is the arbitrage profits in Dollars today after the entire set of trades (buying/selling bonds, changing Euro cash flows today to Dollars) have been completed?

- A)**
- B)**
- C)**
- D)**

- 1) D**
- 2) C**
- 3) A**
- 4) C**
- 5) B**
- 6) D**
- 7) B**
- 8) B**
- 9) A**
- 10) A**

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