

EC 247 Financial Instruments and Capital Markets

Class Exercise 6

These questions correspond to chapter 15 of the Frederic S. Mishkin and Stanley G. Eakins, *Financial Markets and Institutions*, 7th Edition, Pearson Prentice Hall, 2012.

Question 1

If the Japanese price level rises by 5% relative to the price level in the United States, what does the theory of purchasing power parity predict will happen to the value of the Japanese yen in terms of dollars?

Question 2

The Mexican peso is trading at 10 pesos per dollar. If the expected U.S. Inflation rate is 2% while the Mexican inflation rate is 23% over the next year, what is the expected exchange rate in one year?

Question 3

An investor in Canada purchased 100 shares of IBM on January 1st at \$93.00/share. IBM paid an annual dividend of \$0.72 on December 31st. The stock was sold that day as well for \$100.25. The exchange rate is \$0.68/Canadian dollar on January 1st and \$0.71/Canadian dollar on December 31st. What is the investor's total return in Canadian dollars?

Question 4

The current exchange rate is 0.75 euros per dollar, but you believe the dollar will decline to 0.67 euros per dollar. If a euro-denominated bond is yielding 2%, what return do you expect in U.S. dollars?

Question 5

The president of the United States announces that he will reduce inflation with a new anti-inflation program. If the public believes him, predict what will happen to the exchange rate for the U.S. dollar.
