ECON 476v8
Assignment 1

Assignment 1 is worth 20% of your final grade and should be done after you have completed Units 1 through 5. Read the requirements for each question and plan your responses carefully. Answer all five questions.

Although your responses should be concise, ensure that you answer all portions of each question completely. The objective of this assignment is for you to synthesize the material presented in Units 1 through 5, and to consider each question rationally and logically.

1. Your Canadian company processes raw sugar for sale in the United States, and the firm has just received a container of raw material from the UK. You have an invoice that asks you to pay £20,000 in 30 days. The current exchange rate is $1.75/£.

   a. What would it cost you, in Canadian dollars, to pay the bill today?

   b. If you thought the dollar would trade at $2.50/£ in 30 days, what should you do?

   c. If you could lock into a forward rate today of $2.25/£ for delivery in 30 days, what should you do?

2. If you wanted to assess the competitiveness of a country, would you focus on its spot exchange rate, its real exchange rate, its effective exchange rate, or some other measure of the company's currency's value? Explain.

3. Using the IS/LM/BP model and assuming perfect capital mobility, explain:

   a. how a decrease in foreign income affects domestic output.

   b. how an appreciation of the domestic currency affects domestic output.

4. The US has experienced large and growing current account deficits for more than 20 years, whereas Japan has experienced large and growing current account surpluses for roughly the same period. The US economy has grown at faster rates than Japan's over the past 10 years.

   a. Use the relationship between the current account and GDP to explain the difference in growth rates between the two economies.

   b. In trade negotiations with the Japanese over the large US trade deficit with Japan, the US administration has urged the Japanese government to undertake a more expansionary fiscal policy. Explain how this might affect the US trade deficit with Japan.

5. Using appropriate models or theories, explain the economic intuition (logic) behind the following events.

   a. An increase in money supply leads to a fall in short-run interest rate.

   b. An increase in real income leads to a rise in short-run interest rate.