Solutions for Exam #2

1. See p. 59 of the text, the middle of the page.

2. Given that the price of a pair of shoes in the U.S. is $80 and 120 DM in Germany, we have:
   \[
   \text{PPP Implied DM/$ Exchange Rate} = \frac{120 \text{ DM}}{\$80} = 1.5 \text{ DM/$},
   \]
   since, at this exchange rate, we can convert the dollar price of a pair of shoes in the U.S. to a Deutsche mark price of 120 DM ($80 \times 1.5 \text{ DM/$} = 120 \text{ DM}$).

3. Given the prices of the tradable good in the U.S. and Mexico, we have:
   \[
   \text{PPP Implied pesos/$ Exchange Rate} = \frac{100 \text{ pesos}}{\$20} = 5 \text{ pesos/$}.
   \]
   Since the current exchange rate, 7 pesos/$, is higher than the PPP-implied exchange rate, we expect the dollar to depreciate, which is equivalent to an appreciation of the peso.

4. See the opening paragraph of the text’s discussion of the Bretton Woods Agreement on p. 76.

5. See the discussion of commodity money, fiat money, and commodity-backed money on p. 71 of the text.

6. See the bottom of p. 71 of the text.

7. Since Ffr107.008 = DM886.672, we know that:
   \[
   \text{Ffr} = \text{DM}(886.672/107.008) = \text{DM}8.286.
   \]
20. See the bottom of p. 106 in the text. The notion of arbitrage is also introduced earlier in the text.

21. See p. 110 of the text.

22. See p. 116 of the text.

23. See p. 117 of the text.

24. See p. 119 of the text.

25. The speculator will sell British pounds on the forward market if it is profitable to do so. Given the speculator’s expectations, note that option (a) enables her to “buy low” (by buying at the expected future spot rate $S_{t+1}$) and “sell high” (by selling on the forward market at the forward rate $F$).