13.1 Exchange Rates

1) The price of one currency in terms of another is called
   A) the exchange rate.
   B) purchasing power parity.
   C) the terms of trade.
   D) a currency band.
   Answer: A
   Diff: 1
   Topic: Section 13.1
   Question Status: Previous Edition

2) An exchange-rate system in which the nominal exchange rate is set by the government is known as
   A) a flexible-exchange-rate system.
   B) a floating-exchange-rate system.
   C) a fixed-exchange-rate system.
   D) an exchange-rate union.
   Answer: C
   Diff: 1
   Topic: Section 13.1
   Question Status: Previous Edition

3) The Bretton Woods system relied on
   A) a flexible-exchange-rate system.
   B) a floating-exchange-rate system.
   C) a fixed-exchange-rate system.
   D) an exchange-rate union.
   Answer: C
   Diff: 1
   Topic: Section 13.1
   Question Status: Previous Edition

4) The real exchange rate is
   A) the price of one currency in terms of another.
   B) the price of domestic goods relative to foreign goods.
   C) the quantity of gold that can be purchased by one unit of currency.
   D) the difference in interest rates between two countries.
   Answer: B
   Diff: 1
   Topic: Section 13.1
   Question Status: Previous Edition

5) When the domestic currency strengthens under a fixed-exchange-rate system, this is called
   A) a depreciation.
   B) an appreciation.
   C) a devaluation.
   D) a revaluation.
   Answer: D
   Diff: 1
   Topic: Section 13.1
6) Three-wheel cars made in North Edsel are sold for 5000 pounds. Four-wheel cars made in South Edsel are sold for 10,000 marks. The real exchange rate between North and South Edsel is four three-wheel cars for three four-wheel cars. The nominal exchange rate between the two countries is
   A) 0.50 marks/pound.
   B) 0.66 marks/pound.
   C) 1.50 marks/pound.
   D) 2.00 marks/pound.
Answer: C

7) Three-wheel cars made in North Edsel are sold for 5000 pounds. Four-wheel cars made in South Edsel are sold for 10,000 marks. The nominal exchange rate between the two countries is three marks per pound. The real exchange rate between the two countries is
   A) 0.50 three-wheel cars per four-wheel car.
   B) 0.67 three-wheel cars per four-wheel car.
   C) 1.50 three-wheel cars per four-wheel car.
   D) 2.00 three-wheel cars per four-wheel car.
Answer: B

8) When the domestic currency buys fewer units of foreign currency, the
   A) nominal exchange rate rises.
   B) nominal exchange rate falls.
   C) real exchange rate rises.
   D) real exchange rate falls.
Answer: B

9) When the nominal exchange rate falls,
   A) the domestic currency buys more units of foreign currency and the domestic currency has depreciated.
   B) the domestic currency buys fewer units of foreign currency and the domestic currency has depreciated.
   C) the domestic currency buys more units of foreign currency and the domestic currency has appreciated.
   D) the domestic currency buys fewer units of foreign currency and the domestic currency has appreciated.
Answer: B

10) From 1980 to 2000, the yen/dollar exchange rate fell from 240 yen/dollar to 102 yen/dollar, while the dollar/pound exchange rate fell from 2.22 dollars/pound to 1.62 dollars/pound. As a result,
    A) the dollar appreciated relative to the yen, but depreciated relative to the pound.
    B) the dollar depreciated relative to the yen, but appreciated relative to the pound.
    C) the dollar appreciated relative to both the yen and the pound.
    D) the dollar depreciated relative to both the yen and the pound.
Answer: B
11) When the nominal exchange rate in terms of dollars per yen rises,
   A) the dollar buys more yen and the dollar has depreciated.
   B) the dollar buys fewer yen and the dollar has depreciated.
   C) the dollar buys more yen and the dollar has appreciated.
   D) the dollar buys fewer yen and the dollar has appreciated.
   Answer: B
   Diff: 2

12) A rise in the real exchange rate is called
   A) a real depreciation.
   B) a real appreciation.
   C) a real bargain.
   D) a real devaluation.
   Answer: B
   Diff: 1

13) For a given real exchange rate, a nominal appreciation of the domestic currency will result from
   A) a decline in the terms of trade.
   B) an increase in the prices of foreign goods.
   C) an increase in the prices of the domestic goods.
   D) an increase in the domestic rate of inflation.
   Answer: B
   Diff: 3

14) If the real exchange rate rises 2%, domestic inflation is 3%, and foreign inflation is 1%, what is the percent change in the nominal exchange rate?
   A) 6%
   B) 4%
   C) 2%
   D) 0%
   Answer: D
   Diff: 2

15) If the real exchange rate rises 4%, domestic inflation is 2%, and foreign inflation is 0%, what is the percent change in the nominal exchange rate?
   A) 6%
   B) 4%
   C) 2%
   D) 0%
   Answer: C
   Diff: 2
16) If the nominal exchange rate rises 5%, domestic inflation is 2%, and foreign inflation is 3%, what is the percent change in the real exchange rate?
   A) 8%
   B) 6%
   C) 4%
   D) 2%
Answer: C
Diff: 2
Topic: Section 13.1
Question Status: Previous Edition

17) If all countries produce the same good (or the same set of goods) and goods are freely traded among countries, so that the real exchange rate equals one, then the relationship between domestic and foreign prices and the nominal exchange rate is
   A) \( P = \frac{P_{for}}{enom} \)
   B) \( P = \frac{enom}{P_{for}} \)
   C) \( enom = P \times P_{for} \)
   D) \( P = P_{for} \)
Answer: A
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

18) The idea that similar foreign and domestic goods, or baskets of goods, should have the same price when priced in terms of the same currency is called
   A) equity.
   B) purchasing power parity.
   C) efficiency.
   D) the tragedy of the commons.
Answer: B
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

19) Purchasing power parity means that
   A) \( enom = \frac{P_{for}}{P} \)
   B) \( P = P_{for} \)
   C) \( P = enom / P_{for} \)
   D) \( enom = mc^2 \)
Answer: A
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

20) Empirical evidence shows that in the short run, purchasing power parity ________, and in the long run, purchasing power parity ________.
   A) holds; does not hold
   B) holds; holds
   C) does not hold; holds
   D) does not hold; does not hold
Answer: C
Diff: 1
Topic: Section 13.1
21) Purchasing power parity does not hold in the short to medium run because
   A) exports don't equal imports.
   B) exchange rates fluctuate too much.
   C) most business cycles are caused by shocks to aggregate demand.
   D) countries produce different goods.
   Answer: D
   Diff: 1
   Topic: Section 13.1

22) Purchasing power parity does not hold in the short to medium run because
   A) exports don't equal imports.
   B) exchange rates fluctuate too much.
   C) some goods aren't internationally traded.
   D) most business cycles are caused by shocks to aggregate demand.
   Answer: C
   Diff: 1
   Topic: Section 13.1

23) Suppose purchasing power parity holds. If the price level in the United States is 100 dollars per good and the price level in Japan is 250 yen per good, then the nominal exchange rate is ________ yen per dollar.
   A) 0.25
   B) 0.4
   C) 2.5
   D) 4.0
   Answer: C
   Diff: 2
   Topic: Section 13.1

24) Suppose purchasing power parity holds. If in 1997 the price level in the United States is 100, the price level in Japan is 10,000, and the nominal exchange rate is 100 yen per dollar, while in 1998 the price level in Japan rises to 10,500 and the nominal exchange rate rises to 105, then the price level in the United States in 1998 must be
   A) 95.
   B) 100.
   C) 105.
   D) 110.25.
   Answer: B
   Diff: 2
   Topic: Section 13.1

25) Relative purchasing power parity occurs when
   A) purchasing power parity holds between every two countries.
   B) purchasing power parity only holds in recessions.
   C) the nominal exchange rate is constant.
   D) the real exchange rate is constant.
   Answer: D
   Diff: 1
   Topic: Section 13.1
26) When the rate of appreciation of the nominal exchange rate equals the foreign inflation rate minus the domestic inflation rate, we say there is
   A) relative purchasing power parity.
   B) purchasing power parity.
   C) a Phillips curve.
   D) an aggregate supply shock.
   Answer: A
   Diff: 1
   Topic: Section 13.1
   Question Status: Previous Edition

27) When the dollar rises relative to other currencies,
   A) foreign goods are more expensive in terms of dollars.
   B) foreign currency is more expensive in terms of dollars.
   C) U.S. goods become more expensive to foreigners.
   D) foreign currency is more expensive in the United States, but foreign goods are cheaper.
   Answer: C
   Diff: 2
   Topic: Section 13.1
   Question Status: Previous Edition

28) When the British pound rises in value relative to other currencies, then
   A) goods imported into Britain rise in price.
   B) British exports rise in price.
   C) neither British exports nor imports rise in price.
   D) both British exports and imports rise in price.
   Answer: B
   Diff: 2
   Topic: Section 13.1
   Question Status: New

29) Suppose the euro/yen exchange rate falls while the dollar/yen exchange rate rises. What happens to the price of goods imported into Japan?
   A) European goods become more expensive while U.S. goods become cheaper.
   B) European goods become cheaper while U.S. goods become more expensive.
   C) Both European and U.S. goods become more expensive.
   D) Both European and U.S. goods become cheaper.
   Answer: A
   Diff: 2
   Topic: Section 13.1
   Question Status: Previous Edition

30) Suppose the Swiss franc rises against the British pound but falls against the Japanese yen. What happens to the prices of goods imported into Switzerland?
   A) Both British and Japanese goods fall in price.
   B) Both British and Japanese goods rise in price.
   C) British goods rise in price while Japanese goods fall in price.
   D) British goods fall in price while Japanese goods rise in price.
   Answer: D
   Diff: 2
   Topic: Section 13.1
   Question Status: New
31) A depreciation of the dollar causes
   A) a decrease in U.S. exports.
   B) an increase in U.S. imports.
   C) an increase in the prices of U.S. imports.
   D) an increase in the prices of U.S. exports.
Answer: C
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

32) When the euro falls in value relative to other currencies, then
   A) goods imported into Europe rise in price.
   B) European exports rise in price.
   C) neither European exports nor imports rise in price.
   D) both European exports and imports rise in price.
Answer: A
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

33) Suppose the dollar/euro exchange rate falls. Then
   A) French firms will import more from the United States into France.
   B) U.S. firms will export less to France.
   C) the dollar is less valuable relative to the euro.
   D) the euro is more valuable relative to the dollar.
Answer: B
Diff: 2
Topic: Section 13.1
Question Status: Previous Edition

34) There’s been a real depreciation of the dollar over the past month. In the long run, you would expect the quantity of
   A) American imports to fall and the quantity of American exports to fall.
   B) American imports to rise and the quantity of American exports to rise.
   C) American imports to fall and the quantity of American exports to rise.
   D) American imports to rise and the quantity of American exports to fall.
Answer: C
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

35) The J curve implies that a real depreciation will cause
   A) the nominal exchange rate to appreciate in the short run and depreciate in the long run.
   B) the nominal exchange rate to depreciate in the short run and appreciate in the long run.
   C) net exports to fall in the short run and rise in the long run.
   D) net exports to rise in the short run and fall in the long run.
Answer: C
Diff: 1
Topic: Section 13.1
Question Status: Previous Edition

36) The rapid depreciation in the dollar from 1985 to 1987 caused net exports during this period
   A) to rise as the J curve would have predicted, but with a short lag (less than one year).
   B) to rise as the J curve would have predicted, but with a long lag (more than one year).
C) to fall as the J curve would have predicted, but with a short lag (less than one year).
D) to fall as the J curve would have predicted, but with a long lag (more than one year).

Answer: B

37) According to the “beachhead effect,” in order to undo the effects of a strong-dollar period, the real value of the dollar
   A) must fall to at least half of its value before appreciation of the dollar began.
   B) must fall to the value it had before appreciation of the dollar began.
   C) must fall to a much lower level than it had before appreciation of the dollar began.
   D) must actually appreciate before it depreciates to undo the effects of a strong-dollar period.

Answer: C

13.2 How Exchange Rates Are Determined: A Supply–and–Demand Analysis

1) Under a flexible-exchange-rate system, an increase in the demand for Japanese yen would cause the U.S. dollar/Japanese yen exchange rate to
   A) fall.
   B) rise.
   C) remain unchanged, because supply also increases.
   D) remain unchanged, because the exchange rate is set by the central bank.

Answer: B

2) In a flexible-exchange-rate system, the value of a currency is determined by
   A) the government.
   B) the intersection of the IS and LM curves.
   C) the demand and supply for the currency in the foreign exchange market.
   D) Swiss gnomes.

Answer: C

3) An increase in domestic output would cause a _______ in net exports and a _______ in the exchange rate.
   A) rise; rise
   B) rise; fall
   C) fall; rise
   D) fall; fall

Answer: D

4) A rise in the domestic real interest rate would cause a _______ in net exports and a _______ in the exchange
rate.

A) rise; rise  
B) rise; fall  
C) fall; rise  
D) fall; fall  
Answer: C  
Diff: 2  
Topic: Section 13.2  
Question Status: Previous Edition

5) Which of the following changes would cause American net exports to increase?  
   A) An increase in the real value of the dollar  
   B) An increase in American income  
   C) An increase in foreign income  
   D) A shift in demand by American consumers away from domestically produced goods  
Answer: C  
Diff: 1  
Topic: Section 13.2  
Question Status: Previous Edition

6) Which of the following changes would cause American net exports to decrease?  
   A) A decrease in the real value of the dollar  
   B) A decrease in American income  
   C) An increase in foreign income  
   D) A shift in demand by American consumers away from domestically produced goods  
Answer: D  
Diff: 1  
Topic: Section 13.2  
Question Status: Previous Edition

7) The U.S. real interest rate rises relative to the British real interest rate. British net exports _______ and the British exchange rate _______.  
   A) increase; rises  
   B) increase; falls  
   C) decrease; rises  
   D) decrease; falls  
Answer: B  
Diff: 2  
Topic: Section 13.2  
Question Status: Previous Edition

8) The Japanese real interest rate declines relative to the German real interest rate. German net exports _______ and the German exchange rate _______.  
   A) increase; rises  
   B) increase; falls  
   C) decrease; rises  
   D) decrease; falls  
Answer: C  
Diff: 2  
Topic: Section 13.2  
Question Status: New