

## Suggested Solutions to Assignment 6

### Part A

### Multiple-Choice Questions

1. A
2. C
3. C
4. C
5. B
6. B
7. B
8. A
9. A
10. D
11. C
12. B
13. D
14. D
15. B
16. D
17. A
18. B
19. B
20. B
21. A
22. A
23. D
24. D
25. D
26. A

## Part C

## Problem Solving Questions

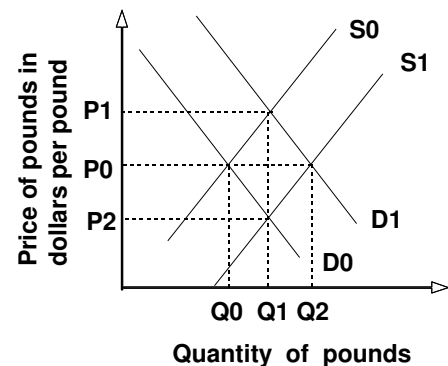
Answer all parts of the following question.

C-1

### Chapter 16: Problems and Exercises - Number 1

The graph to the right shows the fundamental analysis of the supply and demand for British pounds sterling in terms of dollars, and the effect of the following changes:

- a. A rise in the UK price level causes foreign goods to become cheaper. British demand for foreign goods will tend to increase and foreign demand for British goods will tend to decrease. So, demand for British demand for foreign currencies will tend to increase, and foreign demand for pounds will tend to decrease. Thus supply of pounds shifts outward from  $S_0$  to  $S_1$  and the demand for the pound shifts inward from  $D_1$  to  $D_0$ . The value of the pound falls from  $P_1$  to  $P_2$ .
- b. The Canadian price level rising has the effect noted above, but the graph illustrates the impact of the change in the value of the dollar on the pound in terms of dollars. As the value of the dollar falls, the value of the pound in terms of the dollar rises, and so shifts are opposite to those of part a. That is the supply of pounds shifts inward from  $S_1$  to  $S_0$  and the demand for the pound shifts outward from  $D_0$  to  $D_1$ . The value of the pound rises from  $P_2$  to  $P_1$ .
- c. A boom in the UK economy means an increase in its income, causing an increased demand for imports and an increase in the demand for the foreign currency to buy those imports, thus resulting in an increase in the supply of pounds. Thus, the supply of pounds shifts outward from  $S_0$  to  $S_1$ . If demand is at  $D_0$ , the value of the pound falls from  $P_0$  to  $P_2$ .
- d. If interest rates in the UK rise, there will be an increased demand for its assets, so the demand for pounds will increase from  $D_0$  to  $D_1$  and the supply of pounds will decrease from  $S_1$  to  $S_0$  as fewer British investors sell their pounds to buy foreign assets. The value of the pound rises from  $P_2$  to  $P_1$ .



## Chapter 16: Problems and Exercises - Number 5

- a. Current account
- b. Current account
- c. Current account
- d. Current account
- e. Capital account