MGE-9 assignment

1. What is the “real” exchange rate, and why are changes in it more important than changes in the nominal exchange rate.
2. Does the “real exchange rate” have meaning only for a country, or does it have meaning for a company, as well? Explain.
3. Suppose England’s real exchange rate relative to the United States was 1.32. What does this mean? Is there an opportunity to arbitrage the markets? If so, explain how, and if not, explain why not.
4. Suppose England decided to fix its exchange rate relative to the Euro as a precursor to joining the European Monetary Union. Under these circumstances, is it possible for England’s real exchange rate to change?
5. Suppose you picked up the Wall Street Journal and read the following headline: “U.S. dollar rises on international markets.” After reading the article, you discover that the U.S. dollar did rise against the Canadian dollar, Mexican peso, and Japanese yen, but it fell against the euro, Swiss franc, British pound, Thai baht, and Indian rupee. Is this a case where the Wall Street Journal reporter should have written a more carefully articulated article? Was he/she wrong to make a general statement (i.e., “U.S. dollar rises on international markets”) when the dollar moved in different directions against different currencies?
6. Using supply and demand analysis, explain the effect each of the following economic changes has on the Swedish Krone value of the Brazilian real. Also, what effect do these transactions have on the respective countries’ monetary bases?
   a. A decline in the real interest rate on Krone securities relative to real securities.
   b. A rise in Brazilian real GDP relative to Sweden.
   c. A decline in Sweden’s inflation rate relative to Brazil.
   d. The Bank of Brazil intervenes to raise the value of the real.
   e. A growing expectation that Brazil will impose exchange controls on the real.
7. Suppose you were an investment portfolio manager, and you were currently satisfied with the composition of your internationally diversified portfolio. What changes would you make in the portfolio if you expected the U.S. money supply to grow rapidly in the future relative to the euro money supply? Explain.
   a. If your views were shared generally, what would happen to U.S. interest rates, euro interest rates, and the spot exchange rate between the dollar and the euro as a result of your (and other participants) actions?
8. What are the major advantages of having a global currency? (What name would you give to this global currency?)
9. Why are fixed exchange rates a problem for any nation coming under speculative pressure?