

11. In early 1990, Japanese and German interest rates rose while U.S. rates fell. At the same time, the yen and DM fell against the U.S. dollar. What might explain the divergent trends in interest rates?
 - a. Are these inflation and interest rates consistent with the Fisher effect?
 - b. What might explain this difference in interest rates between the United States and Germany?
12. In late December 1990, 1-year German treasury bills yielded 9.1%, whereas 1-year U.S. treasury bills yielded 6.9%. At the same time, the inflation rate during 2006 was 6.3% in the United States, double the German rate of 3.1%.
 - a. Are these inflation and interest rates consistent with the Fisher effect?
 - b. What might explain this difference in interest rates between the United States and Germany?
13. The spot rate on the euro is \$0.91, and the 180-day forward rate is \$0.91. What are the possible reasons for the difference between the two rates?
 14. German government bonds, or Bunds, currently are paying higher interest rates than comparable U.S. treasury bonds. Suppose the Bundesbank eases the money supply to drive down interest rates. How is an American investor in Bunds likely to fare?
 15. In 1993 and early 1994, Turkish banks borrowed abroad at relatively low interest rates to fund their lending at home. The banks earned high profits because rampant inflation in Turkey forced up domestic interest rates. At the same time, Turkey's central bank was intervening in the foreign exchange market to maintain the value of the Turkish lira. Comment on the Turkish banks' funding strategy.
10. In early 1989, Japanese interest rates were about 4 percentage points below U.S. rates. The wide difference between Japanese and U.S. interest rates prompted some U.S. real estate developers to borrow in yen to finance their projects. Comment on this strategy.
9. What factors might lead to persistent covered interest arbitrage opportunities among countries?
 - d. During this same period, Peru had a small interest differential and yet a large average exchange rate change. How would you reconcile this experience with the international Fisher effect and with your answer to Part (b)?
8. Over the period 1982–1988, a number of countries (e.g., Pakistan, Hungary, Venezuela) had a small or negative interest rate differential and a large average annual depreciation against the dollar. How would you explain these data? Can you reconcile these data with the international Fisher effect?
 - c. What might account for Chile's high interest rate relative to its inflation rate? What are the likely consequences of this high interest rate?
 - b. What might account for Peru's low interest rate relative to its high inflation rate? What are the likely consequences of this low interest rate?
7. How would you characterize the real interest rates of Peru and Chile (e.g., close to zero, highly positive, highly negative)?
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4. In early 1989, Japanese interest rates were about 4 percentage points below U.S. rates. The wide difference between Japanese and U.S. interest rates prompted some U.S. real estate developers to borrow in yen to finance their projects. Comment on this strategy.
3. If expected inflation is 100% and the real required return is 5%, what should be the nominal interest rate according to the Fisher effect?
 - a. Based on these figures, what are the real interest rates in France and Germany?
 - b. To what would you attribute any discrepancy in real rates between France and Germany?
2. Two countries, the United States and England, produce only one good, wheat. Suppose the price of wheat is \$3.25 in the United States and is £1.35 in England.
 - a. According to the law of one price, what should the \$:£ spot exchange rate be?
 - b. Suppose the price of wheat over the next year is expected to rise to \$3.50 in the United States and to £1.60 in England. What should the 1-year \$:£ forward rate be?
1. From base price levels of 100 in 2000, Japanese and U.S. price levels in 2003 stood at 98 and 109, respectively.
 - a. If the 2000 \$:£ exchange rate was \$0.00928, what should be the exchange rate in 2006?
 - b. In fact, the exchange rate in 2006 was $\text{¥} 1 = \$0.00860$. What might account for the discrepancy? (Price levels were measured using the consumer price index.)
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5. In July, the 1-year interest rate is 12% on British pounds and 9% on U.S. dollars.
 - a. If the current exchange rate is \$1.63:£1, what is the expected future exchange rate in 1 year?

PROBLEMS