Fiscal & Financial System in Japan A / International Finance

Fall 2012

Midterm Exam

13:30 - 14:30 Nov 13, 2012

- This is a closed book exam.
- Please write clearly. Poor handwriting will be ignored.
- Graded answer sheets will be returned to the students in a few weeks.
- You can withdraw anytime during the exam provided that you are sure you finished the exam.
- For answers and comments on the midterm, visit my website: `http://www1.meijigakuin.ac.jp/~iwamura/`

Multiple-Choice Questions(5 points for each question)

1. Suppose that $G = 250$, $T = 300$, $I = 125$, $S = 100$, and $M = 275$. What is the value of export?
   (a) -25
   (b) 25
   (c) 250
   (d) 300
2. If there is a short-term capital outflow out of the US into Japan, the outflow will appear as
   (a) a credit on the Japan's capital account.
   (b) a credit on the Japan's current account.
   (c) a debit on the Japan's capital account.
   (d) a debit on the Japan's current account.
3. Which of the following affect the demand for dollars on the foreign exchange market?
   (a) U.S. tourists going on holiday.
   (b) Apple buying LCD panels from Japan Display.
   (c) A U.S. speculator buying shares on the Tokyo Stock Exchange.
   (d) Nippon Steel (a Japanese firm) buying raw materials from overseas.
4. Gross Domestic Product can be measured as the sum of
   (a) final goods and services, intermediate goods, transfer payments, and rent.
   (b) consumption, investment, government purchases, and trade balances.
   (c) consumption, transfer payments, wages, and profits.
   (d) Net National Product, Gross National Product, and Disposable personal income.
   (e) investment, wages, profits, and intermediate production.

5. In the U.S. balance of payments accounts, a deficit in the current account
   (a) traditionally produces a surplus in the next year.
   (b) means that foreigners bought more from the U.S. than the U.S. did from foreigners.
   (c) is usually offset by financial and capital account surpluses.
   (d) signals macroeconomic anemia.
6. Credits in financial and capital accounts are transactions that
   (a) increase a country's assets or reduce its liabilities.
   (b) reduce a country's assets or increase its liabilities.
   (c) reduce either a country's assets or its liabilities.
   (d) increase either a country's assets or its liabilities.
7. During the past four decades, the U.S. balance of payments
   (a) had a deficit in the capital account.
   (b) had a surplus in the trade account.
   (c) was never close to balancing (credits equal debits).
   (d) experienced a current account deficit that resulted in foreigners buying substantial U.S. capital assets.
8. A country's current account
   (a) surplus equals the change in its foreign wealth.
   (b) deficit equals the change in its foreign wealth.
   (c) balance equals the change in its foreign wealth.
   (d) balance equals the change in its net foreign wealth.
   (e) None of the above.
9. If the dollar interest rate is 10 percent, the yen interest rate is 6 percent, and the expected rate of dollar depreciation against the yen is 4 percent, then
   (a) an investor should invest only in dollars.
   (b) an investor should invest only in yens.
   (c) an investor should be indifferent between dollars and yens.
   (d) It is impossible to tell given the information.
10. If the yen interest rate is 0.01 and the dollar interest rate is 0.02, the yen/dollar exchange rate is currently 79 and is expected to be 78.1 a year from today, then
   (a) an investor should invest only in dollars.
   (b) an investor should invest only in yens.
   (c) an investor should be indifferent between dollars and yens.
   (d) It is impossible to tell given the information.

11. If the current account balance is -$30 billion, and the capital account balance is $25 billion, then the official settlements account balance is ______ billion, and the official reserves _________.

    (a) -$5 / decrease
    (b) $5 / increase
    (c) -$5 / increase
    (d) $5 / decrease

Essay Questions

1. Can you think of reasons why a government might be concerned about a large current account deficit? (15 points)
2. Suppose that in London 0.6 pounds per dollar, while in New York 120 yens per dollar and in Tokyo 180 yens per pound. Is it possible to exploit any arbitrage opportunity? Explain why? (10 points)
3. People sometimes talk about U.S "twin deficits" where the twins are the trade deficit and the government budget deficit. Explain why these two deficits are twins and how they are related economically so that changes in one are reflected in changes in the other. (Hint: Use the national income identity and derive the relationship between the government budget balance and the trade balance.) (20 points)