Key

15% (5%) A) See point A for $C_n, C_L, R_n, S_D, I_A$

7 - (1 + R^A)

(5%) $I_n^A, R_n^B$

B) See points Q, C for

Foreign savings outflows

Trade surplus

$C_L^A$, but $C_n$ ambiguous

so $S_D$ ambiguous.

(5%) C) In future, $Y_L^B$ but $C_L^B$. Trade deficit due to foreign savings inflows that offset gap between $C_L^B$ and $Y_L^B$.

Yes, it is better off.

10% $C_1$

(3+3)

Free Trade Equilibrium

is at Q and $C_1$.

The net outflow reduces $C$ to $C_2$.

(4%) $P_i(Q_i - C_i) - P_a(C_A - Q_A) + S_F = 0$

If $S_F < 0$ and $C_i < C_A$, exports $\uparrow$, imports $\downarrow$. 

(3) Savings Outflow $D \uparrow$

$ET \uparrow$, $NX \uparrow$

(4) IS: $Y = C + I + G + NX$, where $I = f(R)$, $C = f(M)$, and $NX = f(Y)$

3 points LM: $M/P = L(Y, R)$

(3 points) A tax refund increases $C$, so IS $\uparrow$

for this: $M \uparrow$ makes LM $\downarrow$

R $\downarrow$ immediately, but $\uparrow$ L T

and R $\uparrow$ back.

Net effect: Y $\uparrow$, R ambiguous

$NX \downarrow$ as Imports $\uparrow$

(5) a) $R = \sigma + R^* - \sigma^* + \left[ \frac{E^c}{E} - 1 \right]$

as $\sigma \uparrow$, $E \uparrow$

as $M \uparrow$, R $\downarrow$, so $ET \downarrow$ again

Since $ET$, $\left[ \frac{E^c}{E} - 1 \right] \downarrow$ to compensate

b) If $p_c \uparrow$, $E^c \uparrow$, so $ET \downarrow$

(ceteris paribus

(3 points)
6%  (4 points each)

(a) CAB = (1023 - 1861) + (423 - 343) + (670 - 604) - 90 = -802
(b) SD = (-802 + 4 + 1860 - 1055 + 29) = -28 (debit)

An import of an illegal drug is consistent with it, or any unreported payment to foreigners.

c) OSB = 440 - (-2) = 442
BOP = -442 (Deficit)

d) Because FCB was buying dollars by supplying Forex, EV.

15%  (7 points)

d) Midpoint spot = 103385 American $, 0.9673 European Spread = 0.03% of midpoint (3 points)

(b) \[ \frac{\text{CHF}}{\text{€}} = \frac{\text{CHF}}{\text{€}} = 0.9673 / 1.0328 = 0.9348 \] (3 points)

c) The forward premium on CHF is 3.0135, or 1.4% for 1/2 year (3 points)

d) Simple parity: \[ R = R^* + \left( \frac{E^f}{E} - 1 \right) \] (2 points)

Precise parity: \[ \frac{E^f}{E} = \left( 1 + R \right)^n \] (1 point)

e) If \( R = 1.7\% \), \( R^* = 1.7\% - 2.14\% = -1.1\% \) (3 points)

10%  (8 points)

(a) Speculating: MXP may appreciate, or not depreciate as much as 6% (3 points)
(b) Hedging (4 points)

c) Hedging. Return should be the same, since \( R = R^* + \left( \frac{E^f}{E} - 1 \right) \)

10%  (Bonus)

(a) is the best option. You could also sell MXP forward, but this was not in (b). Insure yourself with a call option, in case MXP does not depreciate, or even appreciates. $0.12 is cheaper. You would be out of the money, you will not strike, and you make $100,000 over (b) or (c), less the price of the $0.12 option.