

Econ 463 Quiz 1 Key

- a) On a midpoint \bar{E} of 1.16509, the spread is 0.03%, or +/- 0.015%.
- b) The direct $E = 0.858303$
- c) CHF/€ = \$/€ / \$/CHF = 1.277 / 0.858303 = 1.48782
- d) The yield is $10,000 / 9940 - 1 = 0.006036 = 0.60\%$
(this is 60 basis points)
- e) Approximately: $\left(\frac{\Delta E}{E}\right)^f = 0.60\% - 1.01\% = -0.41\%$

Precisely: $\left(\frac{\Delta E}{E}\right)^f = \left(\frac{1+i}{1+i^*}\right)^1 - 1 = -0.40\%$

The Euro forward discount is 0.4%. It is expected to depreciate to 1.271862.

- f) Waiting ~~can~~ would be speculating. If the Euro depreciates more than 0.4%, you win. If less, you lose.

g) Hedging

h) Hedging

i) A call option - you are the holder.

A strike price of \$1.25 costs more. An American option costs more. If E rises to \$1.40, you will strike. Depending on the strike price, you would have been better off with (g) or (h), but the option is much better than (f). You avoided losing money.

- j) Speculating. If the Euro appreciates more than -0.4%, you win. If not, you lose.