1) The Euro is currently trading at $1.36 on the spot market, while the British Pound is trading at $1.55. What is the price of the Euro, in Pounds, to the pence?

\[
\frac{1.36}{1.55} \quad \text{Spot price for Euro} = £ 0.88
\]

2) A one-year U.S. Treasury Bill with a $10,000 face value is currently selling for $9,964. What is the annual yield for this T-Bill? Report the yield in percentage terms, with two decimal places (each hundredth is called a basis point).

\[
(9,964)(1.00\%) = 10k
\]

T-Bill yield = 0.36\%

3) The current yield on U.K. Government Bonds is 0.72%. Assuming the risk is equivalent what is the one-year forward rate for the Pound, and what is the forward premium/discount rate? (You may use the simple IRP equation.)

One year forward price = $1.54

(premium/discount) = 0.36\%

4) Suppose the U.S. Federal Reserve unexpectedly announces it will raise interest rates sooner than everybody expected. Assume the T-Bill yield instantly rises to 2.50%. If both the Euroland interest rate and the forward rate for the Euro remain unchanged, what is the new Euro spot rate?

\[
R - R^* = 2.50\% - R^* = \frac{E_U}{E} - 1
\]

Spot price for Euro = $1.33

5) On a graph of the forex market, show what happens to supply, demand, and the exchange rate when domestic interest rates rise. How should this affect the flow of foreign savings in (or out) of the U.S., and how should this affect the trade balance?

- foreign savings (flow in, flow out, neither)
- trade (increases, decreases, neither)

(Could also be a decrease in demand)
6) Using a diagram for a country producing on its PPF and exporting good 2 in exchange for an equal value of good 1, show how the above change in the foreign exchange rate will affect current consumption, utility, and the quantity of both exports and imports. Assume the terms of trade are unaffected.

Consumption shifts out | 1 |
Utility rises | 1 |

2 pts for graph

Exports decrease | 1 |
Imports increase | 1 |