1) The current Canadian Dollar (CAD) and UK Pound (GBP) eurocurrency interest rates are approximately equal (around 1.2%) over an one year maturity. From this information, what do you expect is the relation between the current equilibrium CAD/GBP exchange rate and its expected future level? Suppose that the CAD eurocurrency interest rate falls to 1% per year, but the expected future (1-year-ahead) CAD/GBP exchange rate does not change, assume that it is currently 1.69. If the GBP eurocurrency interest rate also remains constant (at 1.2%), what is the new equilibrium CAD/GBP spot exchange rate? Explain

2) Suppose that I give you $1000 today, with the agreement that you will use this money in a year's time to purchase some French wines, with the following known costs:
   48 Euros per bottle import cost
   $5 local handling cost per bottle

   Assume that the current spot exchange rate (S) is 6 euro/$. The euro/$ exchange rate at the end of the year is uncertain, with:
   probability = 1/2   S= 5 euro/$
   probability = 1/2   S= 7 euro/$

   You can divide your $1000 between a US $ bank account and a Euro bank account. Assume that the $ account pays 10% interest and the Euro account pays 20% interest (Note: these numbers are hypothetical!).

   a) First assume that you place all the money in the $ account, what is the expected number of wine bottles that you can buy at the end of the year?
   b) Re-do part (a) with all your money invested in the Euro account.
   c) Can you find a mixed portfolio allocation in which you are perfectly hedged, that is, the number of bottles you can purchase is invariant to the exchange rate at the end of the year (i.e. all uncertainty will be eliminated). Do you have to sacrifice expected returns to achieve this reduction in risk?

3) The annualized 30-day eurocurrency interest rates in Japan and the U.K. are 0.29 percent and .65 percent respectively, and the current JPY/GBP spot rate is 144 (data are from Feb 2, 2010).

   a) Calculate the 30-day JPY/GBP forward rate (assuming that covered interest-rate parity holds)?
   b) Suppose you observe that the 30-day JPY/GBP forward rate is being quoted at 140. Is there an arbitrage opportunity? Specify the steps you would take to undertake such an arbitrage.

4) How would you expect a fall in a country’s population to alter its aggregate money demand function? Would it matter if the fall in population were due to a fall in the number of households or to a fall in the average size of a household?