Problem Set 7
(due Tuesday, October 28)

Econ 383

1. Consider the data on exchange and interest rates from packet 5 and answer the following questions:

   a. Looking at the interbank interest rates on yen and dollar deposits of one year maturity, do you think that markets expect the yen to appreciate or depreciate against the dollar?

   b. Does covered interest rate parity between yen and dollar hold at one year horizon?

   c. Does covered interest rate parity between yen and dollar hold at one month horizon?

   d. Given the risks of recession the Fed may cut interest rates in the near future. What do you think will happen to the dollar yen exchange rate?

2. Read pages 179 to 182 and 189 to 190 of the attached article entitled Anomalies: Foreign Exchange and briefly answer the following questions:

   a. Taking into account both the theory and the empirical evidence on the interest rate parity condition as outlined in class and the article, and the fact that the interest rates are higher in Europe than in the U.S., would you put your money into dollars or Euros?