Lecture: 19 International Parity Conditions

Short Questions

1. Assume the following information:
Spot rate of Canadian dollar $.80
90-day forward rate of Canadian dollar $.79
90-day Canadian interest rate 4%
90-day U.S. interest rate 2.5%

Given this information what would be the yield (percentage return) to a U.S. investor who used covered interest arbitrage? Assume the investor invest $1,000,000

2. Define and explain the difference between the following pairs of terms:
- **a. Spot market vs. Forward market**
- **b. Interest rate arbitrage Vs. Covered interest arbitrage**
- **c. Real exchange rate Vs. Nominal exchange rate**

3. Assume: (1) the U.S. annual interest rate = 10%; (2) the Germany annual interest rate = 4%; and (3) the 90-day forward rate for the German mark = $.3864. At what current spot rate will interest rate parity hold?

4. Suppose annual inflation rates in the U.S. and Brazil are expected to be 5% and 90%, respectively over the next year. If the current spot rate for the Brazilian cruzeiro is 3342.62 cruzeiros per dollar find out what would be the best estimate of the cruzeiro's future spot rate one year from now.