**1.1**

“A country’s balance of payments tracks the supply and demand for its currency. Since the balance of payments on capital plus current account is always zero, supply must always be equal to demand and therefore the exchange rate never changes.”

Where is the flaw in this logic?

**1.2**

Many countries have black markets for foreign exchange. What conditions do you think explain why some countries have a black market in foreign currency, while others have none? Illustrate the situation using a diagram like Figure 1.1.

**1.3**

1. Why is nobody interested in the balance of payments of California?
2. Should Americans worry about the size of the deficit in the current account of the US balance of payments?
3. Should we be interested in the balance of payments of the Eurozone member countries?
4. Should we be interested in the balance of payments of the Eurozone as a whole?

**1.4**

**D**oes the Bank of England hold Pounds Sterling in its reserves? If not, why not? What about the US Federal Reserve?

**1.5**

Are the problems involved in fixing an exchange rate the same as those involved in fixing the price of a commodity e.g. petrol?

**1.6**

Given the following quotations at two banks:

|  |  |  |
| --- | --- | --- |
|  | $US | |
| Bank A | Bank B |
| Bid rate for $HK | 0.1285 | 0.1279 |
| Ask rate for $HK | 0.1292 | 0.1284 |

Is there an arbitrage opportunity? If so, how much profit could you make starting with $US1M ?

**1.7**

﴾a﴿ Is there a limit to how long a country can sustain a surplus or deficit on its long term capital account?

﴾b﴿ Is there a limit to how long a country can sustain a surplus or deficit on its current account?