Facultat de Ciències Polítiques i de Sociologia
Grau de Ciència Política i de Gestió Pública

Economia i comerç internacional (International Economics)

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Problem set 3

(Due on April 28th 2016)

1. Bulgaria usually imports cars at a price of 8000 € each. The Bulgarian government is convinced that national enterprises could produce cars at a price of 6000 €, but after a learning period. In fact, they actually produce cars that can be sold in the internal market at the price of 10.000 € each.

- Let us consider that national firms decide to keep on producing car even if they are expected to face losses for the initial period. Which are the condition(s) that would make this choice sustainable under an economic viewpoint if we consider it as a rising industry?
- Let us also consider the case that after a trial period, various national Bulgarian car makers can get established on their internal market. Other local entrepreneurs may consider to join the group of the current car makers. How are the potential consequences on the dynamics of the rising industry?

2. Look at the following information about the Exchange parities between a simple of European currencies and ECU (1 ECU=…, Source BdE)

	Spanish Peseta	Deutsche Mark	French Franc
09.01.1995	154,250	1,94964	6,53883
06.03.1995	162,493	1,91007	6,40608
14.10.1996	162,493	1,91007	6,40608
25.11.1996	163,826	1,92573	6,45863
16.03.1998	168,220	1,97738	6,63186
31.12.1998	166,386	1,95583	6,55956

a) Calculate the exchange rate between Spanish Peseta and Deutsche Mark on September 01st 1995 and on January 01st 1997 and determine which currency appreciates.
b) Calculate the narrowest target zone of Spanish Peseta (± 2.25%) on March 16th 1998 and check if the official conversion rate between Spanish Peseta and EURO lies inside such a band.
c) On January 1st 1998, a German investor receives a payment of 10000 ECU. The same operator must pay 10000 ECU on January 1st 1999. In the meanwhile, the same operator aims at earning financial interests from the investment of the available capital. There are two feasible and available alternative options with the same maturity at 1-year:
   - Investment in Spanish Peseta with a 5.50%-year interest rate.
   - Investment in Deutsche Mark with a 2.50%-year interest rate.

The operator cannot split its capital into different options, and he cannot also invest for a period less than one year. Which of the previous options would guarantee the highest returns to the investor and allow her to pay back the due money on time?

3. The current rates in the financial market are: spot exchange rate 2 \$/Pound; 12-month interest rate for a 60-days bond in US \$: 5%; 12-month interest rate for a 60-days bond in UK Pounds 11%. World investors nurture expectations that the expected spot exchange rate (in 60 days) is 1.98 \$/Pound:

- Determine the fulfillment of the uncovered interest rate parity.
- What could be the potential effect on the spot exchange rate of a decrease in the interest rate of a 60-days bond in UK Pounds to 8% (instead of 11%)?
- Keeping fixed the interest rate of bonds in UK Pounds at 8%, and the spot exchange rates, we assume that the uncovered interested parity is retrieved: which value of the expected exchange rate will guarantee such parity? Does the UK Pounds appreciate or depreciate?