

International Finance - Econ 3331**Assignment 2****Due date and time: 28 September 2011, 14:35****1. General instructions**

This assignment is intended to apply in real world contexts several concepts we have learned in the course. Your answers to these assignment questions must reflect your individual work and knowledge. You **cannot** work in groups and share your findings with others.

You must follow the policy on *Academic Integrity* stated in the course syllabus and the *Style Guidelines* attached to Assignment 1. Answer the questions using an essay format with appropriate figures, tables and references: state your data sources in a note to each table and figure, and show or explain your calculations clearly. Your essay will be marked based on research, logic and organization, and analysis, as well as writing style appropriate for the level of this course (see the course website for the grade rubric). Your analysis, arguments and conclusions must be based on verifiable evidence.

Late assignments will be marked down by 10 percent per day.

2. Assignment

Background.—Those *new* concepts that form the background knowledge for this assignment include: the law of one price, the purchasing power parity. In this assignment, you are asked to examine the link between prices and exchange rates.

Object.—Your essay should address the following issues.

(a) Using a traded good as an illustrative example, and the law of one price, determine the implied spot exchange rate between the Canadian dollar and the U.S. dollar (CAN\$/US\$). You must read Pippenger and Phillips (2008) before you answer this part.

(b) Using at least three distinct traded goods, determine the purchasing power parity exchange rate between the Canadian dollar and the U.S. dollar (CAN\$/US\$).

(c) Consider a resident of Halifax, and a resident of Chicago in the United States. Using at least three distinct traded goods and two non-traded goods, determine the purchasing power parity exchange rate between the Canadian dollar and the U.S. dollar (CAN\$/US\$) relevant for these residents. (Ensure that traded goods prices include transportation costs in the form of shipping and handling.) How does this compare to your answer to part **b**)?

You must report your findings in an essay format. Your essay must have a title, and the following structure:

1. **Introduction:** The introduction must grab the attention of the reader, and state the purpose of your essay. See Turabian (2010, Chapters 6–8) for effective writing.
2. **Main body:** The main body of your essay should briefly discuss your method(s). There should be a table, which shows the current nominal (spot) exchange rate (in terms of the

U.S. dollar), a purchasing power parity based exchange rate of the Canadian dollar from an official publication, such as the Bank of Canada and OECD. You should report your own findings in the same table for each of the parts **(a)**–**(c)**. In each case you should compare the spot rate with the implied exchange rate that you compute. Your discussion should inform the reader about whether the Canadian dollar is currently under- or over-valued relative to the U.S. dollar. See Turabian (2010, Chapter 11) for guidance on effective tables.

3. **Conclusion:** The conclusion should synthesize your findings, and discuss their basic economic (policy) implications.
4. **Data Appendix:** Present your **raw** data in a single table contained in an appendix. Do not report more than 2 or 3 digits unless essential.

Maximum 2 double-spaced pages (plus maximum 1 page Data Appendix).

References

- Pippenger, John, and Llad Phillips, 2008. Some pitfalls in testing the law of one price in commodity markets. *Journal of International Money and Finance* 27, 915–925, URL <http://www.sciencedirect.com/science/journal/02615606>.
- Turabian, Kate L., 2010. *Student's Guide to Writing College Papers*. University of Chicago Press, Chicago and London, 4 edn. Available at the Killam Library Reference Desk Collection.