

International Finance - Econ 3331**Assignment 3****Due date and time: 5 October 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.

This assignment involves discussion, which is a high order cognitive skill. A *discussion* identifies an important question related to an issue, and if there are several equally credible sides to this issue, a good discussion explores as much of the relevant evidence and information on a topic as it can.

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 uncovered interest parity condition, covered interest parity condition. The uncovered interest parity condition forms the backbone of many models in international macroeconomics. This condition, assumes risk neutrality and perfect capital mobility, and can be used to make a prediction about future values of the exchange rate. In this assignment, you are asked to examine this aspect of the uncovered interest parity condition.

Object.—You are asked to compute the expected exchange rate implied by the uncovered interest parity condition using the Canadian dollar – U.S. dollar exchange rate as an illustrative example. In order to answer this question, you must obtain quarterly (or annual) data, and use any fifteen year period starting from 1974 or later. If you are using quarterly data, ensure that your interest rates correspond to three month interest rates. Most interest rates are reported on an annualized basis and in percent. The compounding period in the uncovered interest parity condition does not necessarily correspond to the compounding period in your data sources.

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. There should be a figure, which shows the realized exchange rates (use a solid line) and the expected exchange rate implied by the uncovered interest parity condition (use dash line) both graphed against time. Your discussion of your findings should include the following elements. Do you find systematic differences between the expected exchange rate implied by the uncovered interest parity condition and the corresponding realized exchange rate? If so, what are some of the potential reasons for these deviations? Ensure to link these reasons to possible violations of the assumptions underlying the uncovered interest parity condition.
3. **Conclusion:** The conclusion should synthesize your findings, and discuss their basic economic (policy) implications.
4. **Appendix:** Present one sample calculation underlying your figure in the main body of your essay. Also, present your **raw** data in a single table (do **not** attach a computer printout from a database; put the data in your own table). Do not report more than 2 or 3 digits unless essential.

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

References

- 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.