TYB Com Semester VI- Business Economics

Question Bank (Objective Type)

Module – 4 Foreign Exchange Market

A) <u>State whether following statements are True or False. (1 Mark each)</u>

1. Spot exchange rate is the rate at which the delivery of foreign exchange has to be made at future date.
2. Forward rate is the exchange quoted for future delivery of currencies exchange.
3. Central bank & commercial banks are the only dealers in foreign exchange market.
4. Arbitrage is the act of buying a currency in one country & selling it in another in order to make profit.
5. Arbitrage helps to equalize the exchange rate.
6. Commercial banks are authorized to deal in foreign exchange market.
7. Hedger enters forward exchange market to cover the risk.
8. There is only a single exchange rate in the foreign exchange market.
9. Forward exchange rates are current exchange rates between two currencies.
10. Commercial banks do not participate in the foreign exchange market.
11. Arbitrage is a risk less activity.
12. Arbitrager earns risk less profit.
13. Forward exchange rates may be higher or lower than spot rate.
14. The demand for foreign exchange is the decreasing function of the rate of exchange.
15. The exchange rate is determined where demand for foreign exchange exceeds supply of foreign exchange.
16. Supply of foreign exchange curve slopping upward.
17. Supply of foreign currency varies directly with the rate of exchange.
18. Demand for foreign exchange & rate of exchange are inversely related.
19. Equilibrium rate of exchange is stable in the short run.
20. The supply of foreign exchange depends on the country's import of goods & services to foreign countries.
21. Any variation in demand or supply of foreign exchange will lead to a variation in the rate of exchange.
22. The rate of exchange is the function of demand & supply of foreign exchange.
23. The rate of exchange will be determined at the point where the internal purchasing power of the two currencies became equal.
24. The PPP theory is free from criticisms.
25. The PPP theory was introduced by Gustav Cassel.
26. The PPP theory is based on the international purchasing power of any two currencies.
27. The PPP theory uses the price index to measure the changes in the equilibrium rate of exchange.
28. The PPP theory takes into account both current & capital accounts.
29. Only the absolute version can be used to determine the equilibrium rate of exchange.
30. The relation version of PPP theory explains changes in equilibrium exchange rate.
31. The absolute version of PPP theory considers both traded & non-traded goods.
32. LERMS was introduced with a dual exchange rate system.

33. FERA gave wide power to RBI.
34. RBI regulates the foreign exchange market.
35. LERMS was introduced which replace unified market determined exchange rate system.
36. When there is a excess supply of dollars the central bank sells dollars in the market.
37. FEMA was replaced by FERA.
38. FEMA confers power to the central government & the RBI.
39. The RBI does not directly deal with the public.
40. Export of gold & jewellery do not need the permission from RBI.
41. The aim of RBI's intervention in the foreign exchange market is to reduce excess volatility.
42. Flexible interest rates are fixed by government authorities.
43. The IMF was established with the objective of promoting exchange rate stability.
44. In fixed exchange rate the rate of exchange depends on forces of demand & supply.
45. The monetary authority (Central Bank) of a country plays an important role under managed flexibility.
46. Fixed exchange rate system is permanently fixed.
47. Preventing volatility of the exchange rate is one of the objectives of RBI's exchange rate management policy.
48. LEARMS brought full convertibility in the current account.
49. A central bank can influence exchange rate through demand and supply.
50. The PPP theory based on the law of one price.
51. The assumptions of the PPP theory are unrealistic.
52. The absolute version of PPP can be used to determine the equilibrium exchange rate accurately.
53. Internal purchasing power is not only factor determining exchange rate between two countries.
54. There are problems in determining the equilibrium exchange rate in the base year.
55. Exports generate demand for foreign exchange.
56. Future expectations play a role in determination of exchange rates.
57. Unilateral payments generate demand for foreign exchange.
58. The equilibrium exchange rate remains static.
59. Higher rate of inflation in India compared to the USA will make dollar price in India fall.
60. Exchange rate changes are independent of a country's economic growth rate.
61. The main function of foreign exchange market is to earn foreign exchange.
62. In India foreign exchange market, money changers operated in retail market.
63. Spot exchange rate is the current exchange rate between the two currencies.
64. Arbitrage eliminates the differences in exchange rate in different markets.
65. Forward exchange rate is the exchange determined at a future date.

Answers:-

1	False	**2**	True	**3**	False	**4**	True	**5**	True
6	True	**7**	True	**8**	False	**9**	False	**10**	False
11	True	**12**	True	**13**	True	**14**	True	**15**	False
16	True	**17**	True	**18**	True	**19**	False	**20**	False
21	True	**22**	True	**23**	True	**24**	False	**25**	True

26	False	**27**	True	**28**	False	**29**	False	**30**	True
31	False	**32**	True	**33**	True	**34**	True	**35**	False
36	False	**37**	False	**38**	True	**39**	True	**40**	False
41	True	**42**	False	**43**	True	**44**	False	**45**	True
46	False	**47**	True	**48**	False	**49**	True	**50**	True
51	True	**52**	False	**53**	True	**54**	True	**55**	False
56	True	**57**	True	**58**	False	**59**	False	**60**	False
61	False	**62**	True	**63**	True	**64**	True	**65**	False

B) <u>Choose the correct answer and rewrite the statement. (1 Mark each)</u>

1. Arbitrage refers to
   a. Arbitrary exchange rate between two markets
   b. Purchase and sell of an asset for the same price
   c. Purchase of an asset in a low price market and its sale in a higher price market
   d. None of the above
2. Which of the following is not included in the wholesale foreign exchange markrt?
   a. Central Bank
   b. Authorized Dealers
   c. Commercial Banks
   d. Tourists
3. Foreign exchange market is the place where
   a. Only foreigners purchase the required currency
   b. Exchange the currencies by the tourists
   c. Exchange the currencies of only foreign countries
   d. Various national currencies are purchased and sold
4. _____is the current exchange rate between two countries.
   a. Spot exchange rate
   b. Forward exchange rate
   c. Arbitrage
   d. Speculation
5. _____is the exchange rate quoted for future delivery of currencies exchange.
   a. Arbitrage
   b. Spot exchange rate
   c. Forward exchange rate
   d. Hedge
6. The functions of foreign exchange market include____
   a. Provision of facilities for transfer of funds
   b. Provision of short term finance for trade.
   c. Provision of facilities for trading.
   d. All of the above
7. _____ is not a function of foreign exchange market.

a. Transfer
b. Hedging
c. Credit
d. Investment

8. Hedgers enter the forward exchange market to _____.
   a. Earn more profit
   b. Cover the risk
   c. Speculate
   d. All of these
9. Hedging operations helps _____ to cover the risks.
   a. Exporters
   b. Importers
   c. Speculators
   d. All of the above
10. The relationship between supply of foreign exchange & rate of foreign exchange is ____.
   a. Direct
   b. Inverse
   c. Negative
   d. None of these
11. The supply of foreign exchange depends on the country's _____.
   a. Export of goods to foreign countries
   b. Export of services to foreign countries
   c. Investment by foreign countries in host country
   d. All of these.
12. Demand for foreign currency is influenced primarily by _____.
   a. Size of export
   b. Size of import
   c. Both a & b
   d. None of these
13. Equilibrium rate of exchange depends on _____.
   a. Demand factors
   b. Supply factors
   c. both a & b
   d. None of these
14. Which of the following will increase the supply of foreign exchange in country?
   a. A reduction in export
   b. Rise in imports of goods
   c. A rise in unilateral payments
   d. A rise in receipts of capital
15. When the demand for foreign exchange rises, with no change in its supply, then
   a. The domestic currency will depreciate against the foreign currency
   b. The domestic currency will appreciate against the foreign currency

c. The foreign will depreciate against the domestic currency
d. The exchange rate will remain constant

16. A high interest rate in the country, assuming that interest rate in the foreign country remains the same, will
    a. Reduced the supply of foreign currency in the home market
    b. Increase the supply of foreign currency in the home market
    c. Increase the demand for foreign currency in the home market
    d. None of these
17. The PPP theory explains
    a. The determination of long term equilibrium exchange rates based on relative price levels of two countries
    b. The determination of short term equilibrium exchange rates based on relative price levels of two countries
    c. The determination of long term equilibrium exchange rates based on long term capital flows between two countries
    d. The determination of long term equilibrium exchange rates based on short term capital flows between two countries
18. Which of the following is not an assumption of PPP theory?
    a. There are no trade barriers between countries
    b. The price index for each of the two countries must be comprised of the same basket of goods
    c. All the prices should be indexed to the same year
    d. Change in the exchange rate changes internal price level
19. If a basket of commodities is sold at Rs 300 in India & the basket of identical commodities sell at $6 in the USA, then the exchange rate expressed as price of $1 in terms of Rupees, will be
    a. Rs. 20
    b. Rs. 40
    c. Rs. 50
    d. None of the above
20. According to the relative version of PPP theory, changes in the equilibrium rate of exchange will be governed by
    a. The absolute purchasing power in the two countries
    b. The changes in the ration of the respective purchasing power in the two countries
    c. The changes in the balance of payments position of the two countries
    d. All of the above
21. The Purchasing Power Parity theory was introduced by
    a. Alfred Marshall
    b. David Ricardo
    c. Gustav Cassel
    d. J.M.Keynes
22. The limitation of Purchasing Power Parity theory includes _____.
    a. Selection of index numbers
    b. Applicable to static economy

c. Applicable in long run
d. All of these

23. FEMA stands for _____
    a. Foreign Exchange Management Act
    b. Foreign Exchange Marketing Act
    c. Foreign Exchange Import Act
    d. None of these
24. The Foreign Regulation Act came into force 1st January _____.
    a. 2000
    b. 1974
    c. 1976
    d. 1999
25. _____ was introduced as a transitional measure & entailed a dual exchange rate system.
    a. FERA
    b. FEMA
    c. LERMS
    d. None of these.
26. FERA was replaced by _____ in India.
    a. FEMA
    b. FMCG
    c. NEER
    d. LERMS
27. The RBI introduced _____ on 1st March 1993
    a. LERMS
    b. FERA
    c. FEMA
    d. Modified LERMS
28. The main objective of RBI's intervention in the Indian Foreign Exchange market is to __.
    a. Reduced inequalities
    b. Maintain stability
    c. Both a & b
    d. None of these.
29. India adopt _____ exchange rate system.
    a. Fixed
    b. Flexible
    c. Managed
    d. None of these.
30. The _____ has been authorized to issue licenses to those who are involved in foreign exchange transaction.
    a. RBI
    b. Government
    c. Private Companies

d. All of these.

31. The main objectives of RBI's intervention in the Indian foreign exchange market are ___.
    a. To ensure safety of the country
    b. To promote trade
    c. To reduce income inequalities
    d. To maintain exchange rate stability
32. Under the flexible exchange rate system exchange rate is determined by _____.
    a. The monetary authority
    b. The price of gold
    c. The demand & supply of foreign exchange
    d. None of the above.
33. The IMF started to operate in _____.
    a. 1995
    b. 1947
    c. 1944
    d. 1954
34. Between 1947 & 1971, India followed the _____.
    a. Par value system
    b. Basket-Peg system
    c. Managed flexible system
    d. LERMS
35. LERMS was introduced in _____.
    a. 1991
    b. 1980
    c. 1992
    d. 2000
36. In order to prevent appreciation of the rupee against the US $, the RBI will _____.
    a. Sell US $
    b. Sell bonds
    c. Buy bonds
    d. Buy US $
37. When the RBI intervenes to maintain a desirable exchange rate, it is termed as _____.
    a. Sterilized intervention
    b. Managed intervention
    c. Unsterilized intervention
    d. None of the above
38. Under sterilized intervention policy, RBI is likely to _____.
    a. Used OMO
    b. Purchased foreign currencies
    c. Sell foreign currencies
    d. Interest rate manipulation

39. Since 2015 the Rupee has been _____.

a. Appreciating
b. Depreciating
c. Remaining stable
d. None of the above

Answers:-

1	**c**	2	**d**	3	**d**	4	**a**	5	**c**	6	**d**	7	**d**
8	**b**	9	**d**	10	**a**	11	**d**	12	**b**	13	**c**	14	**d**
15	**a**	16	**b**	17	**a**	18	**d**	19	**c**	20	**b**	21	**c**
22	**d**	23	**a**	24	**b**	25	**c**	26	**a**	27	**d**	28	**b**
29	**c**	30	**a**	31	**d**	32	**c**	33	**b**	34	**a**	35	**c**
36	**D**	37	**c**	38	**a**	39	**b**						

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