Country Assignment #2

This group assignment is due on Thursday, December 2, 1999. NO LATE PAPERS WILL BE ACCEPTED. If you cannot deliver the assignment to me in person, please mail it to me (with a legible posting date of December 2 or earlier): Richard Levich, Stern School of Business, New York University, 44 West 4th St., Room 9-63, New York, NY 10012; or fax it to me by December 2 at 212-995-4220. If you fax it, please also turn in a hard copy as soon as possible.

The text of your group's answers to the assignment should be typed single-spaced, with an extra space between each paragraph. The text must be limited to a maximum of three pages. You may also attach additional tables and charts to this three pages of text, if these tables and charts are of direct importance to your discussion.

In your written submission, please list all sources that the group used and found helpful in preparing the report.

The group members are not to discuss this assignment with anyone else who is not in the group (except for consulting reference librarians in order to locate materials). The group may utilize any published materials – you are not limited to the sources noted in the assignment description below.

The Assignment

1. What have been the trends in the nominal exchange rate values (annual averages) of your country's currency since 1980, relative to the U.S. dollar? Relative to the U.S. dollar, has the currency of your country tended to appreciate or to depreciate?

   Most likely source of data (for this part and for the next part): IMF, International Financial Statistics (IFS) Yearbook, or the related monthly issues of the IFS. Use period-average annual values of exchange rates. You need to make sure that you are using the same monetary units for the exchange rate values for your country during the entire period – for some countries you must make adjustments according to information in the source.

2. Calculate and report the real exchange rate values (annual averages) of your country's currency since 1980, relative to the U.S. dollar. In your calculations, use the wholesale (or producer or industrial or home goods) price index (or a similar price index, line 63 of the IFS) if this is available for your country. If this is not available, use the consumer
price index or the GDP deflator. (If none of these are available, please see me to discuss any other alternatives). In reporting the values of these real exchange rates, use a base year of 1980=100. Please attach an appendix in which the methods of calculating the real exchange rates are documented.

Using the values you have calculated for the real exchange rates, discuss how well (or poorly) the concept of (relative) purchasing power parity applies to the exchange rate between your country's currency and the U.S. dollar.

Again, for the variables that you use in your calculations, you will need to make sure that you are using consistent units for each variable over the entire time period.

3. Assume that you are a U.S. investor who calculates your income and wealth in U.S. dollars. Assume further that currently you have an uncovered financial investment denominated in the currency of your assignment country. This investment is about to mature, and you need to decide what you are going to do with the money (an amount of your country's currency) that you about to receive. You are considering two possibilities:

(i) First, you can make another uncovered international financial investment into a short-term or medium-term debt security (or bank deposit) denominated in the local currency.

(ii) Second, you can return home and invest instead in a comparable U.S.-dollar debt security.

The debt security (or deposit) is one issued by a high-quality domestic organization from your assignment country (e.g., the national government, a domestic bank, or a high-grade corporate issuer), and one that matures in one to two years (or one that is as close to this maturity as possible). You will need to find a source that provides the current (or very recent) yield (interest rate) on an appropriate debt security for your assignment country.

Discuss the ingredients that go into the analysis of whether or not to make this uncovered international financial investment. What factors suggest that another uncovered international investment is attractive? What factors suggest that another uncovered international investment is unattractive? What factors are approximately neutral? In your answer to this part, use concepts and tools from the course that are relevant to the analysis. Also, as one part of your answer, refer back to your analysis of the real exchange rate (part 2 of this assignment).

In addition to the data shown in the International Financial Statistics or various national data sources, you might use sources (among other possibilities) such as:

- Listings of yields in the Financial Times or Wall Street Journal.
- Economist Intelligence Unit, Country Profile and Quarterly Economic Review.
- Frost & Sullivan, Political Risk Yearbook.

WWW links on the course web page may also help you locate useful information.