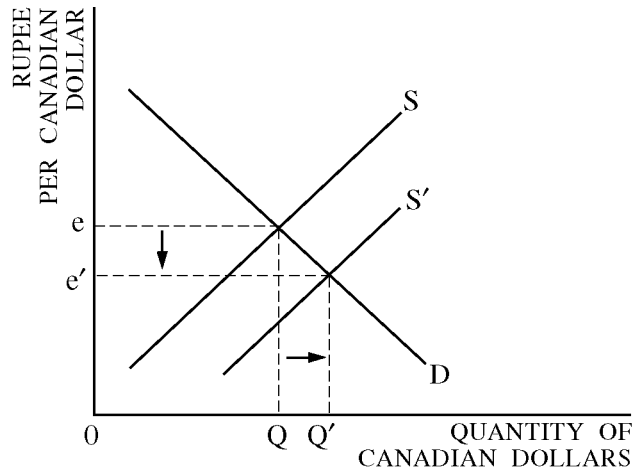


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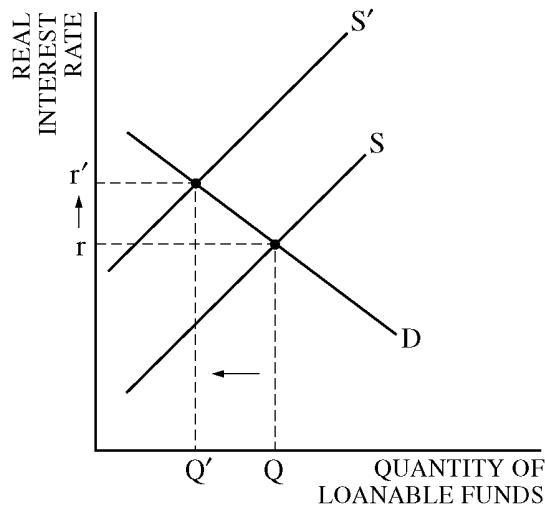
**Question 3**

**6 points** (4 + 2)



(a) 4 points:

- One point is earned for the correctly labeled graph of the foreign exchange market.
- One point is earned for showing that the supply of Canadian dollars will increase, or the supply curve will shift to the right.
- One point is earned for explaining that Canadian investors will be attracted by the higher real interest rate in India and increase their purchase of Indian financial assets.
- One point is earned for showing that the Canadian dollar depreciates against the Indian rupee.



(b) 2 points:

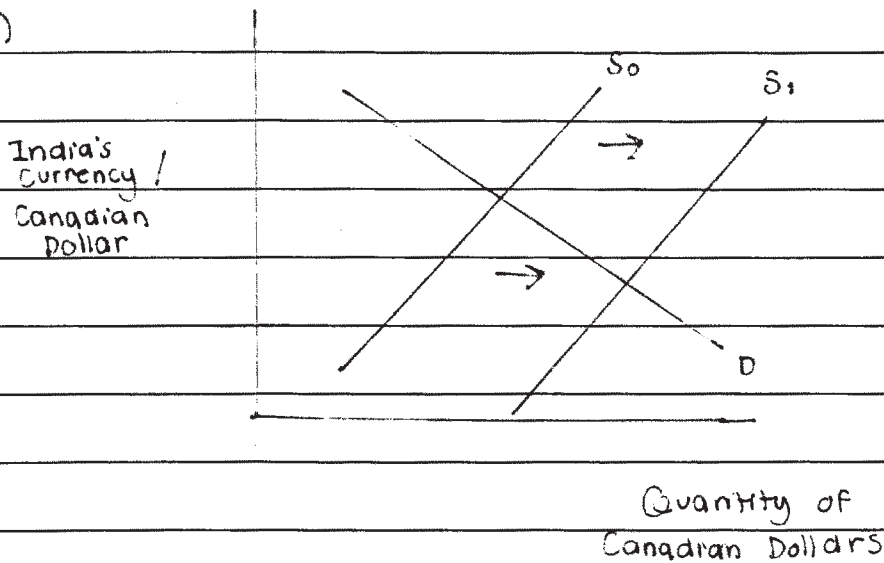
- One point is earned for a correctly labeled graph of the loanable funds market.
- One point is earned for showing a leftward shift of the supply curve and an increase in the interest rate.

Write in the box the number of the question you are answering on this page as it is designated in the exam.

3

3A  
172

a.)



i.) Supply of Canadian dollars increase because there will be an increase in net capital outflow in Canada. As India's real interest rate rise, Canadian would want to save their money, or buy bonds and stocks, in India, and fewer people, both international and Canadian domestic would want to save in Canada. Thus, demand for Canadian dollars decrease and supply of Canadian dollar increase (shifts right).

ii.) The value of Canadian dollar decreases or depreciates relative to Indian currency.

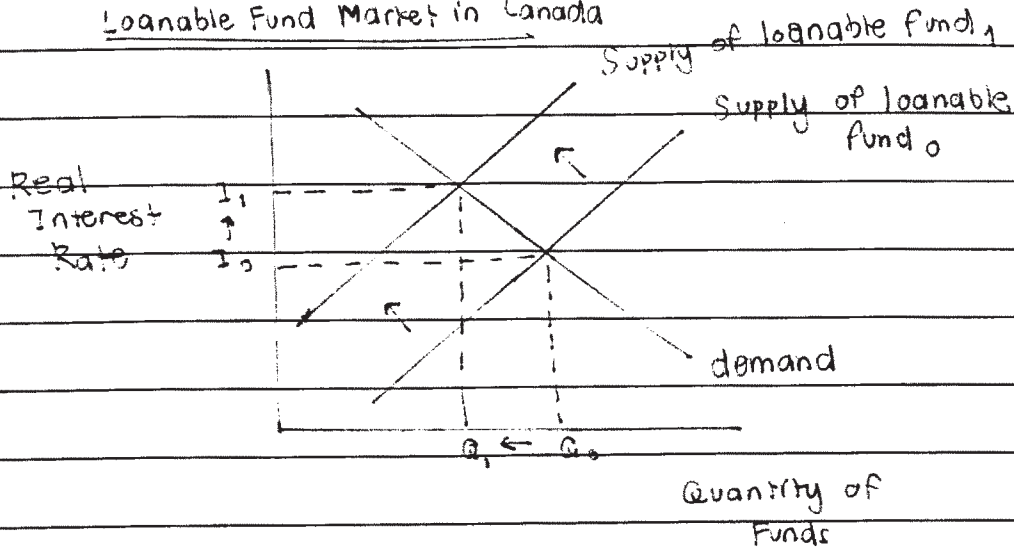
3

Write in the box the number of the question you are answering on this page as it is designated in the exam.

3A  
2 of 2

Loanable Fund Market in Canada

b.)

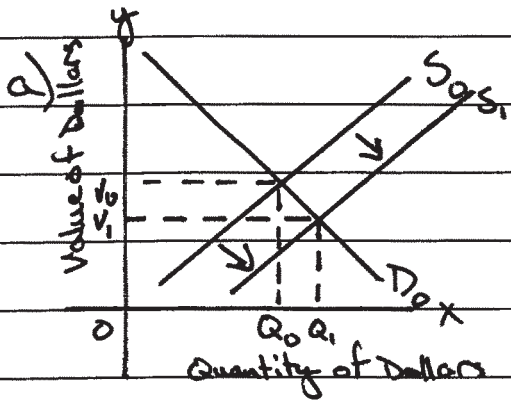


Real Interest rises as supply of loanable fund decreases (shifts to the left). This decrease in supply of fund results from less saving in Canada.

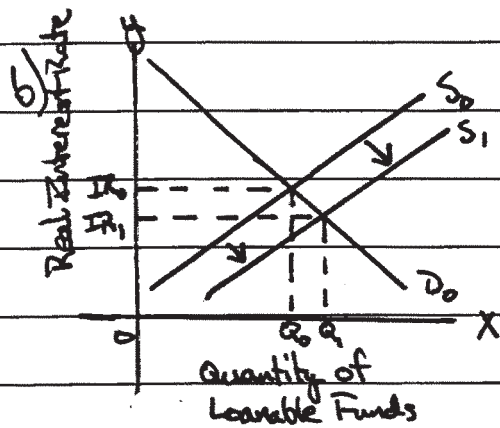
Write in the box the number of the question you are answering on this page as it is designated in the exam.

3

36



- i) The supply of Canadian dollars will increase from  $S_0$  to  $S_1$  because of inflation.
- ii) The value, assuming flexible exchange rates, of the Canadian dollar will decrease.

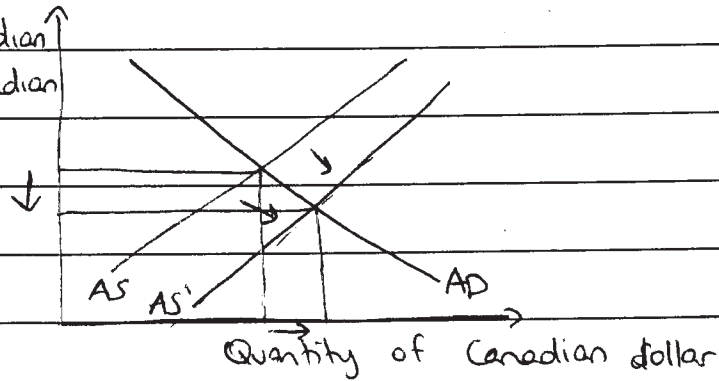


Write in the box the number of the question you are answering on this page as it is designated in the exam.

3

30

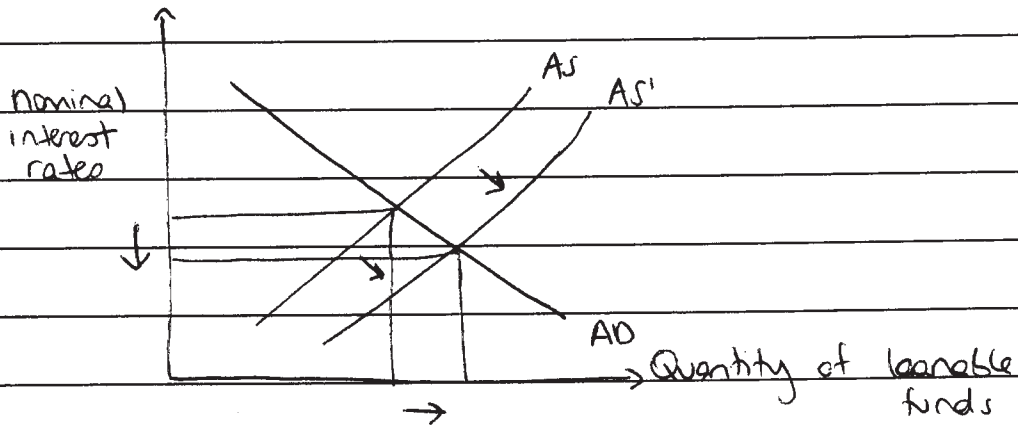
#3) a) Price of Indian currency / Canadian dollar



i) The supply of the Canadian dollar increases since more people are demanding the Indian currency and supplying the Canadian dollar, because of the increase of the interest rates in India.

ii) The value of the Canadian dollar depreciates since its demand decreases, and supply increases.

b)



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**Question 3**

**Sample: 3A**

**Score: 6**

The student earned all 6 points for this question.

**Sample: 3B**

**Score: 4**

The student lost 1 point in part (a) because the explanation of why the supply of Canadian dollars increases is incorrect. The student lost 1 point in part (b) because the supply of loanable funds is not shown shifting to the left.

**Sample: 3C**

**Score: 2**

The student lost 1 point in part (a) because the currency market is not correctly graphed. The student earned 2 points in part (a) for showing the supply curve shifting to the right and for correctly concluding that the Canadian dollar would depreciate. The student lost the other point in part (a) because the explanation is insufficient. The student lost both points in part (b) because the market for loanable funds is not correctly graphed and because the supply of loanable funds is not shown shifting to the left.