

STUDY SESSION

5

Economics

Monetary and Fiscal Policy, International Trade, and Currency Exchange Rates

This study session begins with monetary and fiscal policy, including their use by central banks and governments. Economics in a global context is then introduced. Next follows a discussion on the flows of goods and services and physical and financial capital that occur across national borders. Highlighted in the discussion are the relationships between different types of flows and the benefits of trade to trade partners. Finally, given that operations and investments in global markets involve foreign exchange (currency) risk, the session concludes with an overview of currency market fundamentals.

READING ASSIGNMENTS

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| Reading 18 | Monetary and Fiscal Policy
by Andrew Clare, PhD, and Stephen Thomas, PhD |
| Reading 19 | International Trade and Capital Flows
by Usha Nair-Reichert, PhD, and Daniel Robert Witschi,
PhD, CFA |
| Reading 20 | Currency Exchange Rates
by William A. Barker, PhD, CFA, Paul D. McNelis, and
Jerry Nickelsburg |

LEARNING OUTCOMES

READING 18. MONETARY AND FISCAL POLICY

The candidate should be able to:

- a** compare monetary and fiscal policy;
- b** describe functions and definitions of money;

- c** explain the money creation process;
- d** describe theories of the demand for and supply of money;
- e** describe the Fisher effect;
- f** describe roles and objectives of central banks;
- g** contrast the costs of expected and unexpected inflation;
- h** describe tools used to implement monetary policy;
- i** describe the monetary transmission mechanism;
- j** describe qualities of effective central banks;
- k** explain the relationships between monetary policy and economic growth, inflation, interest, and exchange rates;
- l** contrast the use of inflation, interest rate, and exchange rate targeting by central banks;
- m** determine whether a monetary policy is expansionary or contractionary;
- n** describe limitations of monetary policy;
- o** describe roles and objectives of fiscal policy;
- p** describe tools of fiscal policy, including their advantages and disadvantages;
- q** describe the arguments about whether the size of a national debt relative to GDP matters;
- r** explain the implementation of fiscal policy and difficulties of implementation;
- s** determine whether a fiscal policy is expansionary or contractionary;
- t** explain the interaction of monetary and fiscal policy.

READING 19. INTERNATIONAL TRADE AND CAPITAL FLOWS

The candidate should be able to:

- a** compare gross domestic product and gross national product;
- b** describe benefits and costs of international trade;
- c** distinguish between comparative advantage and absolute advantage;
- d** compare the Ricardian and Heckscher–Ohlin models of trade and the source(s) of comparative advantage in each model;
- e** compare types of trade and capital restrictions and their economic implications;
- f** explain motivations for and advantages of trading blocs, common markets, and economic unions;
- g** describe common objectives of capital restrictions imposed by governments;
- h** describe the balance of payments accounts including their components;
- i** explain how decisions by consumers, firms, and governments affect the balance of payments;
- j** describe functions and objectives of the international organizations that facilitate trade, including the World Bank, the International Monetary Fund, and the World Trade Organization.

READING 20. CURRENCY EXCHANGE RATES

The candidate should be able to:

- a** define an exchange rate and distinguish between nominal and real exchange rates and spot and forward exchange rates;
- b** describe functions of and participants in the foreign exchange market;
- c** calculate and interpret the percentage change in a currency relative to another currency;
- d** calculate and interpret currency cross-rates;
- e** convert forward quotations expressed on a points basis or in percentage terms into an outright forward quotation;
- f** explain the arbitrage relationship between spot rates, forward rates, and interest rates;
- g** calculate and interpret a forward discount or premium;
- h** calculate and interpret the forward rate consistent with the spot rate and the interest rate in each currency;
- i** describe exchange rate regimes;
- j** explain the effects of exchange rates on countries' international trade and capital flows.