4. When the yen depreciates versus the dollar, costs to a Japanese firm that imports petroleum will rise. This depresses its profits. On the other hand, that firm will be able to export more to the United States (increasing its yen price without changing the dollar price), so there may be some offsetting effects. But, by and large, a firm that has substantial imported input costs does not relish a depreciating home currency.

5. The dollar rates of return are as follows:
   a. \( \frac{($250,000 - $200,000)}{$200,000} = 0.25 \).
   b. \( \frac{($275 - $255)}{$255} = 0.08 \).
   c. There are two parts to this return. One is the loss involved due to the appreciation of the dollar; the dollar appreciation is \( \frac{($1.38 - $1.50)}{$1.50} = -0.08 \). The other part of the return is the interest paid by the London bank on the deposit, 10 percent. (The size of the deposit is immaterial to the calculation of the rate of return.) In terms of dollars, the realized return on the London deposit is thus 2 percent per year.

6. Note here that the ordering of the returns of the three assets is the same whether we calculate real or nominal returns.
   a. The real return on the house would be 25 percent – 10 percent = 15 percent. This return could also be calculated by first finding the portion of the $50,000 nominal increase in the house’s price due to inflation ($20,000), then finding the portion of the nominal increase due to real appreciation ($30,000), and finally finding the appropriate real rate of return ($30,000/$200,000 = 0.15).
   b. Again, subtracting the inflation rate from the nominal return, we get 8 percent – 10 percent = -2 percent.
   c. 2 percent – 10 percent = -8 percent.

7. The current equilibrium exchange rate must equal its expected future level since, with equality of nominal interest rates, there can be no expected increase or decrease in the dollar/pound exchange rate in equilibrium. If the expected exchange rate remains at $1.52 per pound and the pound interest rate rises to 10 percent (5 percent higher than U.S. interest rates), then interest parity is satisfied only if the current exchange rate changes such that there is an expected appreciation of the dollar equal to 5 percent. This will occur when the exchange rate rises to $1.60 per pound (a depreciation of the dollar against the pound).

8. If market traders learn that the dollar interest rate will soon fall, they also revise upward their expectation of the dollar’s future depreciation in the foreign exchange market. Given the current exchange rate and interest rates, there is thus a rise in the expected dollar return on euro deposits from \( R_{EU,1} \) to \( R_{EU,2} \). At the current exchange rate of \( E_1 \), the dollar return on a European asset exceeds the dollar return on a U.S. asset. As investors shift their money into European assets, the dollar will depreciate against the euro. This will drive down the dollar return on European assets until interest rate parity is restored at the new exchange rate \( E_2 \).