

CHAPTER 38 FOREIGN EXCHANGE RATES

A decorative graphic consisting of a grid of circles. The top three rows each contain three yellow circles. The bottom row contains one blue circle on the right side.

Macroeconomics - year11

Agenda

Drive growth of monthly sales volume of purchases

- Multiple choice
- Essay

Be the most desirable brand



RECAP

1. **Foreign exchange rate** is the price of one currency in terms of another currency.
2. **Exchange Rate Systems** : a floating exchange rate system, a fixed exchange rate system and managed floating exchange rate system.
3. **Floating Exchange Rate System**: exchange rates are determined by market forces such as supply and demand without government intervention.
4. **Fixed Exchange Rate System**: governments or central banks set the value of their currency relative to another currency. They may intervene in the foreign exchange market to maintain the fixed rate.
5. **Factors Influencing Demand and Supply of Currency**: Demand and supply of a currency are influenced by factors such as export, import, interest rates, and speculation.

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5. **Factors Influencing Demand and Supply of Currency:** Demand and supply of a currency

influenced by factors such as

- Export
- Import
- Interest rates
- Speculation.

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6. **Consequences of Currency Appreciation:** when a currency increases in value relative to other currencies, It can lead to cheaper imports and reduced export competitiveness and potentially lead to trade deficit.
7. **Consequences of Currency Depreciation:** when a currency decreases in value relative to other currencies. It can make exports more competitive, increase import costs, and potentially lead to trade surplus.

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8. Advantages and Disadvantages of Floating Exchange Rate System:

- **Advantages** include automatic adjustment to trade imbalances, independence in monetary policy, and reduced need for foreign reserves.
- **Disadvantages** include exchange rate volatility and increased speculation.

9. Advantages and Disadvantages of Fixed Exchange Rate System:

- **Advantages** include certainty and stability for trade and investment and reduced speculation.
- **Disadvantages** include lack of flexibility in monetary policy, and potential for speculative attacks.

Part1-Multiple choice

1. Which of the following is most likely to cause an appreciation of a country's currency in a floating exchange rate system?

- A) A decrease in domestic interest rates
- B) A fall in foreign direct investment inflows
- C) An increase in exports due to higher global demand
- D) A rise in inflation relative to trading partners

Part1-Multiple choice

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- D) A rise in inflation relative to trading partners

Answer: C) An increase in exports due to higher global demand

Part1-Multiple choice

2. How would an appreciation of a country's currency affect its trade balance in the short run?

- A) It will always improve the trade balance
- B) It will always worsen the trade balance
- C) Imports become cheaper, and exports become more expensive, potentially worsening the trade balance
- D) Exports increase because they become cheaper, improving the trade balance

Part1-Multiple choice

2. How would an appreciation of a country's currency affect its trade balance in the short run?

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D) Exports increase because they become cheaper, improving the trade balance

Answer: C) Imports become cheaper, and exports become more expensive, potentially worsening the trade balance

Part1-Multiple choice

3. A depreciation of the local currency is more likely to lead to inflation if:

- A) The demand for exports is highly inelastic
- B) The country relies heavily on imported raw materials
- C) The government has a large budget surplus
- D) There is a strong rise in domestic productivity

Part1-Multiple choice

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Answer: B) The country relies heavily on imported raw materials

Part1-Multiple choice

4. A country with a trade deficit is likely to experience which of the following under a floating exchange rate system?

- A) A depreciation of its currency
- B) An appreciation of its currency
- C) A reduction in inflation
- D) A higher demand for its currency in foreign exchange markets

Part1-Multiple choice

4. A country with a trade deficit is likely to experience which of the following under a floating exchange rate system?

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- B) An appreciation of its currency
- C) A reduction in inflation
- D) A higher demand for its currency in foreign exchange markets

Answer: A) A depreciation of its currency

Part1-Multiple choice

5. What is a potential drawback of a fixed exchange rate system?

- A) The country cannot conduct international trade
- B) The central bank may have to use foreign reserves to defend the rate
- C) The exchange rate changes frequently
- D) Inflation is uncontrollable

Part1-Multiple choice

5. What is a potential drawback of a fixed exchange rate system?

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- B) The central bank may have to use foreign reserves to defend the rate
- C) The exchange rate changes frequently
- D) Inflation is uncontrollable

Answer: B) The central bank may have to use foreign reserves to defend the rate

Part2-Essay

- 1 (a) What is meant by the depreciation of a currency? [2]
- 2 (b) Describe how the value of a currency is determined in a floating exchange rate system [4]
- 3 (b) Explain 2 reasons why a government may prefer a weaker currency [4]**
- 4 (c) Analyze the effects of a rise in interest rates on a country's exchange rate. [6]**
- 4 (d) Discuss both the potential advantages and disadvantages of a higher exchange rate on key macroeconomic aims. [8]

Part2-Essay

3 (b) Explain 2 reasons why a government may prefer a weaker currency [4]

Part2-Essay

4 (c) Analyze the effects of a rise in interest rates on a country's exchange rate. [6]

The End

