6 International trade – Part 2

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	**Write it 3 times** (English)		
balance of payments			
current account			
current account deficit			
exchange rate			
floating exchange rate			
fixed exchange rate			
appreciation			
depreciation			

Recall

In **Part 1** you met why countries trade (absolute and comparative advantage) and protectionism. Part 2 looks at the **record** of a country's trade (the balance of payments) and the **price** of its currency (the exchange rate).

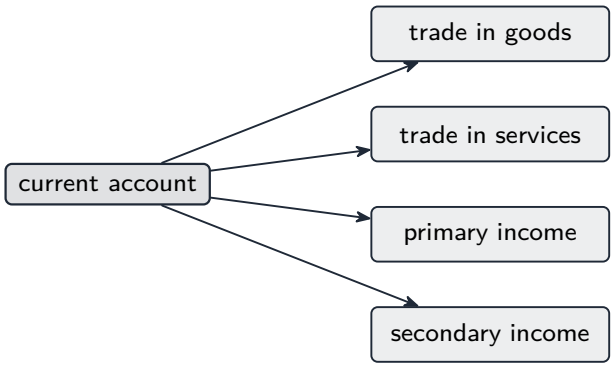
New ideas

1 The balance of payments

The **balance of payments** is a record of all money flows between a country and the rest of the world. Its most-studied part is the **current account**, which has four parts:

- **trade in goods** – exports and imports of physical goods;
- **trade in services** – services like tourism and banking;
- **primary income** – income from work and investment abroad;
- **secondary income** – transfers like foreign aid.

A **current account deficit** means a country buys more from abroad than it sells.



Micro-check. What does a current account **deficit** mean? [1]

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2 Exchange rates

An **exchange rate** is the price of one currency in terms of another. Two main systems:

- a **floating exchange rate** is set freely by the **demand for** and **supply of** the currency;
- a **fixed exchange rate** is held at a set value by the central bank.

Micro-check. Under a **floating** system, what sets the exchange rate? [1]

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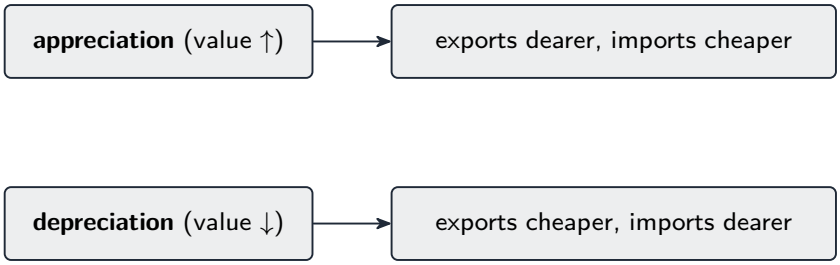
3 Appreciation and depreciation

Under a floating rate:

- **appreciation** is a **rise** in the currency's value → exports become dearer for foreigners, imports become cheaper;

- **depreciation** is a **fall** in the currency's value → exports become cheaper, imports become dearer.

A depreciation can therefore raise export sales and cut imports (helping the current account), but it can also raise inflation, because imports cost more.



Micro-check. After a **depreciation**, do exports become cheaper or dearer for foreigners? [1]

Watch out: a current account *deficit* = buy more from abroad than you sell. Appreciation (currency rises) → exports *dearer*, imports *cheaper*; depreciation (falls) → exports *cheaper*, imports *dearer*. A depreciation can help the current account but raise inflation.

Practice

6.1 Name the **four** parts of the **current account**. [4]

6.2 State what a **current account deficit** means. [1]

6.3 Define an **exchange rate**. [1]

6.4 State one difference between a **floating** and a **fixed** exchange rate. [2]

6.5 A country's currency **depreciates**. State the effect on (a) its exports and (b) its imports. [2]

6.6 Challenge. A country with a large current account deficit sees its currency depreciate. Explain how the depreciation could help reduce the deficit. [2]