Past-paper walk-through

Exchange rates ▪ 6.4

eXercise

Questions in this set

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Question 20

9708/11 N25 ▪ Q20 ▪ 1 mark

20 The aggregate demand (AD) curve in an economy shifts to the left.

What is most likely to cause this shift?

A a decrease in the exchange rate

B a decrease in the interest rate

C an increase in the budget deficit

D an increase in the current account deficit

Solution 20

Answer: **D**

Why

- Aggregate demand shifting left means less demand at every price level.
- That follows from lower consumption, investment, government spending or net exports.
- So higher interest rates, higher taxes or a stronger exchange rate would all do it.

Question 30

9708/11 N25 ▪ Q30 ▪ 1 mark

30 A country has a current account deficit on its balance of payments. The government also has a budget deficit.

Which measure to reduce the current account deficit will increase the budget deficit?

A depreciating the exchange rate

B introducing quotas on imports

C raising tariffs on imports

D subsidising exports

Solution 30

Answer: **D**

Why

- Reducing a current account deficit means cutting imports or raising exports.
- A measure that also *raises* government spending, or cuts tax revenue, widens the budget deficit.
- So look for the policy that improves trade at the cost of the public finances – a subsidy to exporters does both.

Question 20

9708/13 N25 ▪ Q20 ▪ 1 mark

20 What might be a consequence of a fall in the domestic price level?

A imports become more competitive

B interest rates increase

C the purchasing power of savings falls

D the real value of incomes increases

Solution 20

Answer: **D**

Why

- A falling price level makes domestic goods cheaper relative to foreign ones.
- So exports become more competitive and imports less so.
- It also raises the purchasing power of savings, since each unit of money buys more.

Question 30

9708/14 N25 ▪ Q30 ▪ 1 mark

30 Both the US and the EU operate in floating exchange rate markets.

The rate of exchange fluctuated greatly during the period shown.

year	US dollar–euro rate of exchange
2000	0.84 dollars per euro
2008	1.59 dollars per euro
2022	1.00 dollar per euro

What would explain the changes in the US dollar–euro rate of exchange?

Question 30

A changes in the supply and demand for dollars and euros in the foreign exchange market

B continuous appreciation of the US dollar throughout the period

C continuous depreciation of the US dollar throughout the period

D restraints placed by trade agreements on the rate of exchange

Solution 30

Answer: **A**

Why

- Both currencies float, so the rate is set by supply and demand for each.
- A rise in the dollar–euro rate means one euro buys more dollars, so the euro has appreciated.
- Large fluctuations create uncertainty, which discourages trade and investment between the two areas.

Question 30

9708/11 J25 ▪ Q30 ▪ 1 mark

30 The table shows the change in the value of UK sterling over a three-month period.

June	Sept
£1 = $1.38	£1 = $1.32

What is likely to be the short-term impact of the change in the value of UK sterling on the UK economy?

A increased disinflation

B increase in cost-push inflation

C more purchasing power of money

D reduced demand-pull inflation

Solution 30

Answer: **B**

Why

- Sterling fell from \$1.38 to \$1.32, so the pound has depreciated.
- That makes UK exports cheaper abroad and imports dearer at home.
- In the short run trade volumes respond only slowly, so the value of imports rises first and the trade balance can worsen.

Question 25

9708/1 23 ▪ Q25 ▪ 1 mark

25 There is a rise in the exchange rate of the US$.

Which would cause the greatest increase in the US current account deficit?

A a high level of domestic unemployment

B a high price elasticity of demand for imports

C a low price elasticity of demand for exports

D a low rate of domestic inflation

Solution 25

Answer: **B**

Question 30

9708/1 23 ▪ Q30 ▪ 1 mark

30 The monetary authorities of a country, whose currency is floating freely, raise the market rates of interest.

Other things being equal, the exchange rate of the currency is most likely to

A fall, as domestic fixed capital formation declines in response to higher rates of interest.

B fall, because the quantity of money must be reduced to cause rates of interest to rise.

C rise, as foreigners buy the domestic currency in order to hold assets with a higher yield.

D rise, as exporters increase the volume of exports to hold foreign currency.

Solution 30

Answer: **C**