

6.3 The Foreign Exchange Market

Name: _____ Class: _____ Date: _____

Total: 9 marks

Objective

Build the skills to answer exam questions on **the foreign exchange market**.

You must be able to:

- model the **foreign exchange market** 外汇市场 with supply of and demand for a currency
- determine the **equilibrium exchange rate**
- relate demand for a currency to demand for that country's exports and assets

1 Worked examples

Study these first. Each one shows the method for a question type used later.

■ Supply and demand for a currency

Foreigners **demand** a currency to buy that country's **exports** and **assets**; the currency is **supplied** when residents buy foreign goods and assets.

■ Equilibrium

The exchange rate settles where the quantity of the currency demanded equals the quantity supplied.

■ Drivers of demand

More demand for a country's exports or assets → more demand for its currency → the currency **appreciates**.

2 Practice

2.1 State what determines the demand for and supply of a currency. [2]

2.2 State what is found at the intersection of currency supply and demand. [1]

2.3 State one reason foreigners demand a country's currency. [1]

3 Exam-style questions

3.1 The equilibrium exchange rate is set by [1]

- A the government alone
 - B supply and demand for the currency
 - C the CPI
 - D the money multiplier
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3.2 Foreigners demand a currency mainly to buy that country's [1]

- A debt only
 - B exports and assets
 - C imports
 - D labour abroad
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3.3 Foreign demand for a country's exports rises.

(a) State the effect on the demand for its currency. [1]

(b) State the effect on the exchange rate. [1]

(c) Name this change in the currency's value. [1]

4 Go further

- work through the **6.3 The Foreign Exchange Market** lesson on the **Learn** page;
- read the **Open Economy** section of the AP Macroeconomics handout on the **Know** page.

Solutions

2.1 demand comes from foreigners buying the country's exports and assets; supply comes from residents buying foreign goods and assets.

2.2 the equilibrium exchange rate.

2.3 to buy that country's exports or assets (any one).

3.1 B.

3.2 B.

3.3 (a) it rises. (b) the exchange rate rises. (c) appreciation.