Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

depreciation: a fall in the value of a currency in a floating exchange-rate system, caused by market forces; devaluation: a deliberate fall in a fixed exchange rate by the government or central bank

2.2

any two: to buy its exports of goods and services, including tourism; to invest in its firms, property or bonds; to speculate; remittances to families

2.3

higher interest rates attract financial investment from abroad (hot money); demand for the currency rises: D shifts right; the exchange rate rises: appreciation; correctly labelled diagram: price of the currency (in another currency) vs quantity, $D_1 \to D_2$, higher rate

2.4

imports become more expensive in the domestic currency; imported consumer goods raise the price level directly / imported raw materials and fuel raise firms' costs; so SRAS shifts left / cost-push inflation; higher demand for exports also adds demand-pull inflation

2.5

$(120-150)\div 150\times 100 = \mathbf{-20}\%$: the dollar depreciates against the yen; before: $30\times 150 =$ ¥4500; after: $30 \times 120 =$ ¥3600

3.1

award up to [10]: exports become cheaper abroad, so export volumes rise; imports become dearer, so import volumes fall; net exports and AD rise: higher real GDP and lower unemployment; the current account balance may improve, depending on PED for exports and imports; imported inflation: dearer imported goods and inputs; lower living standards for those who buy many imports; firms with foreign-currency debts face higher repayments; tourism into the country rises; a clear, structured explanation with an AD/AS or currency diagram

3.2

the central bank buys its own currency using foreign reserves, raising demand; it can raise interest rates to attract capital inflows; strength: certainty for trade and investment; discipline against inflation; weakness: needs large reserves; reserves can run out under speculative attack; interest rates must defend the peg rather than support the domestic economy; judgement: suits small, open economies with strong reserves and close ties to the anchor country

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