

Exercise walk-through

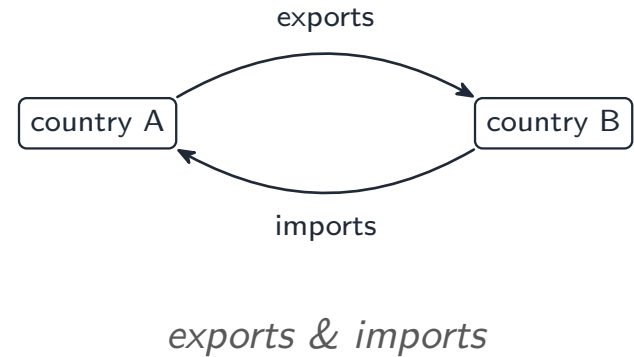
6.3

Foreign exchange rates

IGCSE Economics

What we will cover

- 1 Specialisation & free trade
- 2 Globalisation & MNCs
- 3 Trade protection
- 4 Tariffs
- 5 Exchange rates
- 6 Balance of payments



The four parts of the current account, and free trade's cost

trade in goods

visible exports minus visible imports

trade in services

exports and imports of services – tourism, banking, shipping

primary income

wages, interest and profit **earned from abroad**

secondary income

money sent **with nothing given in return** – aid, and remittances

a surplus

the total is positive; a deficit means the country buys more from abroad than it sells

free trade's cost

new, small industries may never grow if they face strong foreign rivals from the start – the infant-industry argument

A deficit is not automatically bad. It matters how it is financed and whether the imports build future capacity – which is what an evaluation question wants.

Topic 6 – key takeaways

1

Free trade

specialise; cheaper goods & more choice

2

Protection

tariffs, quotas & subsidies

3

Exchange rates

appreciation: dear exports, cheap imports

4

Payments

exports vs imports: surplus or deficit

Exercises 2.1·2.3

2.1 Define the term *exchange rate*.

[2]

2.2 State the effect of a **depreciation** on the price of exports and imports.

[2]

2.3 State what sets a floating exchange rate.

[1]

Exercises 2.1·2.3

2.1 Define the term *exchange rate*. [2]

2.1

- the **exchange rate** is the **price of one currency in terms of another** (K)
-

2.2 State the effect of a **depreciation** on the price of exports and imports. [2]

2.2

- a **depreciation** makes **exports cheaper** (to foreigners) and **imports dearer** (K)
-

2.3 State what sets a floating exchange rate. [1]

2.3

- a floating exchange rate is set by the **demand for and supply of** the currency (K)

Exercises 3.1-3.2

3.1 When a country's currency **appreciates**, its:

[1]

☐

A exports become cheaper and imports dearer

B exports become dearer and imports cheaper

C exports and imports both become cheaper

D exports and imports both become dearer

3.2 Using a currency demand and supply diagram, explain how a rise in demand for a country's exports affects its exchange rate.

[4]

Exercises 3.1-3.2

3.1 When a country's currency **appreciates**, its:

[1]

☐

A exports become cheaper and imports dearer

B exports become dearer and imports cheaper

C exports and imports both become cheaper

D exports and imports both become dearer

3.1 B

- an **appreciation** makes **exports dearer** and **imports cheaper** (K)
- A is a depreciation; C and D treat both sides the same

3.2 Using a currency demand and supply diagram, explain how a rise in demand for a country's exports affects its exchange rate.

[4]

3.2

- draw a currency demand and supply diagram: demand for the currency **shifts right** (K)
- foreigners buying more exports must **buy the currency** (An)
- with supply unchanged, the exchange rate **rises** (an appreciation) (An)

Exercise 3.3

3.3 Analyse how a depreciation of a country's currency affects its exports and imports.[6]

Exercise 3.3

3.3 Analyse how a depreciation of a country's currency affects its exports and imports.[6]

3.3

- a depreciation **lowers** the currency's value (K)
- exports become cheaper for foreign buyers → **exports rise**; imports become dearer → **imports fall** (An)
- this can improve the **current account**, though it may raise inflation as imports cost more (An)