

6.3 Foreign exchange rates

Name: _____ Class: _____ Date: _____

Total: 16 marks

KEY WORDS exchange rate • currency • floating exchange rate
• depreciation • appreciation

Objective

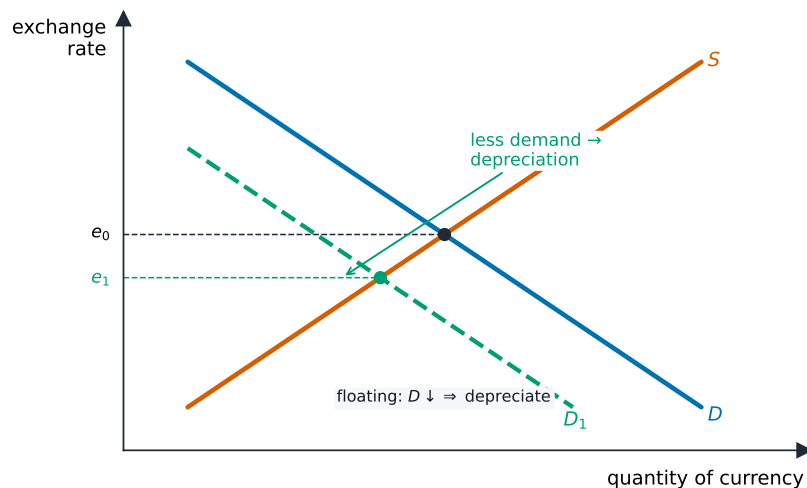
Build the skills to answer exam questions on **foreign exchange rates** – how a **floating exchange rate** is set, and **appreciation and depreciation** and their effects on trade.

You must be able to:

- explain how demand and supply set a floating exchange rate
- distinguish appreciation from depreciation
- analyse the effects of a change in the exchange rate on exports and imports

1 Key knowledge and worked examples

■ The exchange rate



The exchange rate is the price of one currency in another

- **Floating exchange rate** : set by demand for and supply of the currency.
- **Appreciation** : the currency rises → exports **dearer**, imports **cheaper** → exports fall, imports rise.
- **Depreciation** : the currency falls → exports **cheaper**, imports **dearer** → exports rise, imports fall.

Appreciation

(currency rises in value)

exports dearer,
imports cheaper →
exports fall, imports rise

Depreciation

(currency falls in value)

exports cheaper,
imports dearer →
exports rise, imports fall

Exam: appreciation hurts export competitiveness; depreciation can boost net exports (SPICED)

The effects in full: appreciation versus depreciation on export and import prices and the trade balance

Answer shapes: an **Analyse** [up to 6] answer may use a currency diagram; **Discuss** [8] adds a judgement (Ev).

2 Practice

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]

3 Exam-style questions

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]

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