

Exchange Rates

The value or price of a currency expressed in terms of another currency.

Consumers and firms in the UK **SUPPLY** sterling to acquire the currency of a country they wish to trade with or invest in.

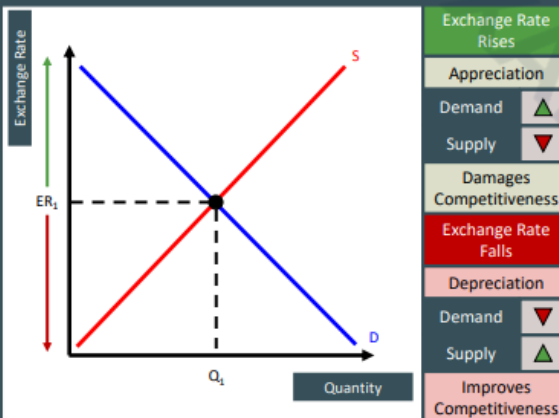
Supply of Currency



Demand for Currency

Consumers and firms in another country **DEMAND** sterling to make investments in or buy goods and services from the UK.

Floating Exchange Rate Systems:



Does not restrict policies

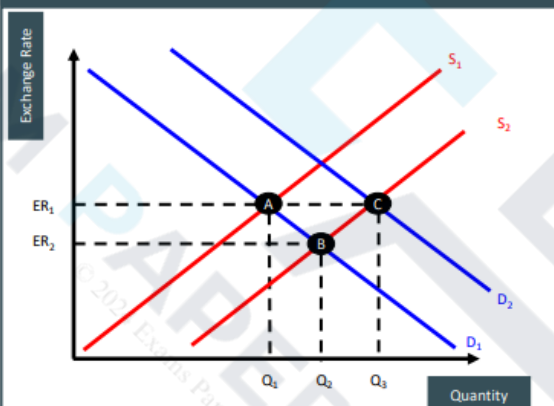
Reacts to trade imbalances

Vulnerable to currency runs

Supports monetary policy

Protects against shocks

Fixed Exchange Rate Systems:



An exchange rate system where the value at which one currency exchanges for another is maintained at a fixed level.

Depends on volume of foreign currency reserves!

Role of Foreign Currency Reserves:

A Original Equilibrium

Number of Imports Sold Increases

Supply of Currency Increases

Excess Supply

To prevent ER from falling...

Central Bank sells currency reserves

IN RETURN FOR...

Own domestic currency

Demand for Currency Increases

No change in ER

C New Equilibrium

<https://www.youtube.com/watch?v=5FaNeRH-GLY>

The European Union Context Extract D (lines 13–14) argues that it 'is not difficult to understand why the pound has fallen against the euro and other currencies'. Explain what is meant by 'the pound has fallen against the euro and other currencies' and analyse two determinants of such a fall. [9 marks]

In January 2009, £1 could buy approximately 1.04 euros on the foreign exchange market. By July 2015, £1 could buy approximately 1.44 euros. Explain the factors that may lead to a rise in the exchange rate of a currency. [15 marks]

Explain the phrase 'devaluation of the exchange rate' (Extract B, line 12) and, with the help of a diagram, analyse how a devaluation of the Chinese currency (the yuan) may affect economic growth in the UK. [9 marks]

An economy which is enjoying rapid economic growth experiences a significant rise in the external value of its currency within a floating exchange rate system. Evaluate the possible macroeconomic consequences for an economy of a rise in the exchange rate of its currency. [25 marks]