

Exchange Rates — Worksheet

Part A — Determination, movements and effects of the \$A

This worksheet builds the exchange-rate skills the exam rewards: using the demand and supply model to explain movements, performing simple currency conversions, and analysing the effects of appreciation and depreciation.

Worked example — conversion. If $A\$1 = \text{US}\0.70 , an export worth $A\$10,000 = \text{US}\$7,000$. If the \$A appreciates to $\text{US}\$0.80$, the same export now costs the foreign buyer $\text{US}\$8,000$ — Australian exports have become dearer.

State the cause (what shifted the curve) *and* the effect (appreciation/depreciation and its consequences) — and always label both the shift and the new equilibrium on your diagram.

Concepts

1. Define an exchange rate and explain what is meant by an *appreciation* and a *depreciation* of the \$A.

2. List two sources of demand for the \$A and two sources of supply of the \$A on the foreign exchange market.

Using the model

3. Draw a demand and supply diagram for the \$A. On it, show the effect of a large increase in foreign investment into Australia. Label the curve shift and the movement from the old to the new equilibrium, and state whether the \$A appreciates or depreciates.

4. For each event, state which curve shifts, in which direction, and the effect on the \$A:

(a) A sharp fall in iron ore prices. _____

(b) The RBA raises the cash rate well above overseas rates. _____

(c) A jump in Australians travelling overseas. _____

Calculation and effects

5. If A\$1 = US\$0.65, how much in US dollars is an export invoice of A\$40,000 worth? If the \$A then appreciates to US\$0.72, recalculate, and explain what this does to the price faced by the American buyer.

6. Analyse the effects of a sustained depreciation of the \$A on (a) exporters, (b) consumers buying imported goods, and (c) inflation.
