

# 3.2 Big Ideas

3.2 Syllabus Items + Big Questions

Why Exchange Rates?

320 Big Ideas 3.2

Search

325 - IB Q's + BIG Ideas for 99

99 - Notetaker

**Syllabus 3.2**

**Exchange Rates**

321 - Demand for a currency

322 - Supply for a currency

323 - Fixed or Variable?

324 - PPP

ERM Before STG Exit

BBC Six o'clock...

ERM After STG Exit

Black Wednes...

Introduction t...

The Big Mac I...

Black Wednes...

You Tube 3.2

Big Mac Index 2015

100 Dictionary

**3.2 - Exchange Rates Dictionary**

1. adjustable peg exchange rate system
2. capital inflow + interest rates
2. currency appreciation

## The BIG ideas!

Exchange Rates: summary

WEBNOTE 320

### I.b Syllabus 3.2: Macroeconomic Objectives: Exchange Rates

## Syllabus 139 - 146

- 320: Powerpoint summary
- 321: Demand for a currency
- 322: Supply for a currency
- 323: Floating, Fixed and Managed
- 324: PPP
- 325: Exam Questions

Big Idea

1

Big Idea

2

Big Idea

3

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Webnote 240

Syllabus reference: items 129 +132

Big Idea

1

DEMAND FOR A CURRENCY IS  
DETERMINED BY 3 FACTORS

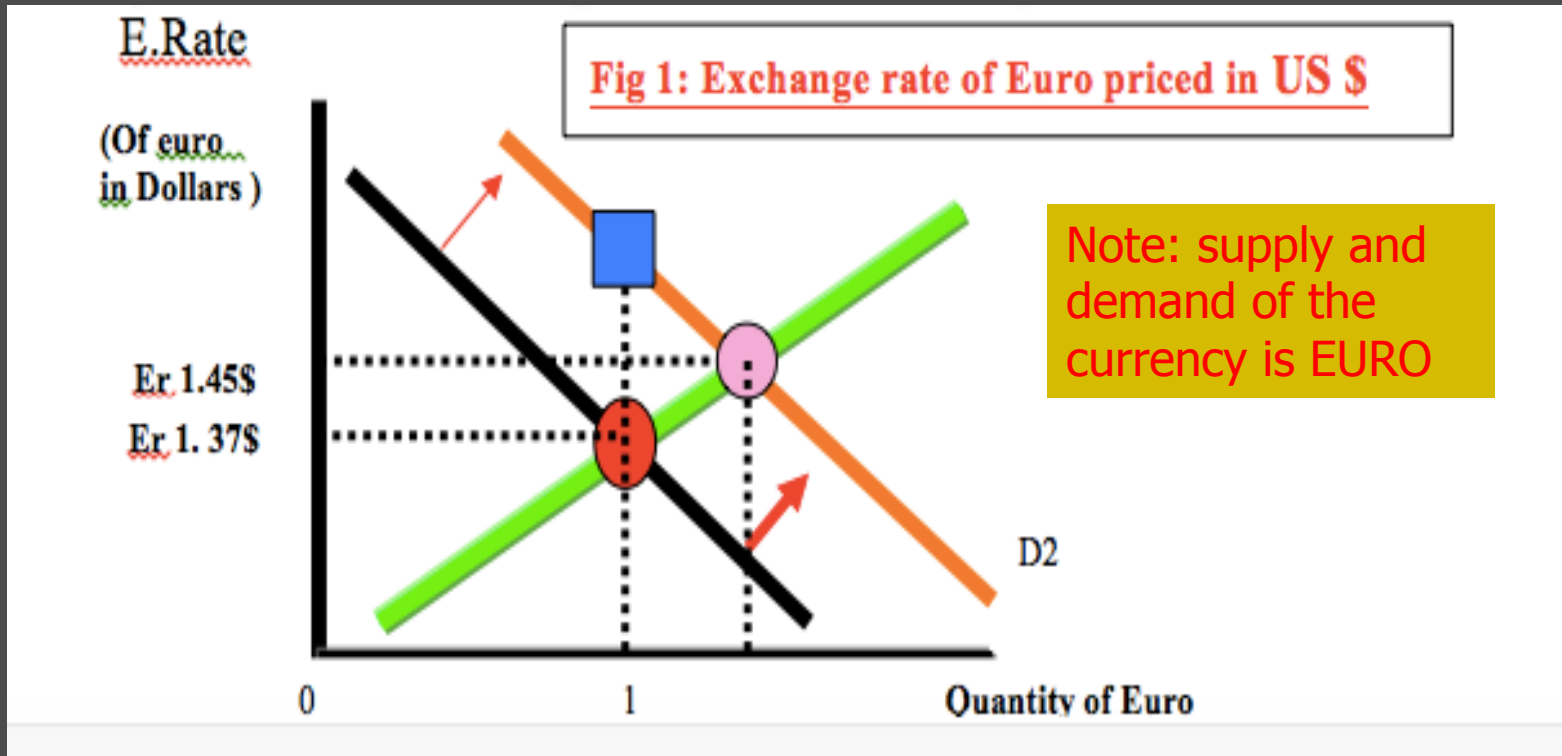
**Demand** determined by:

1. **Save (foreigners)**
2. **Speculate (foreigners)**
3. **Spend (foreigners, X )**

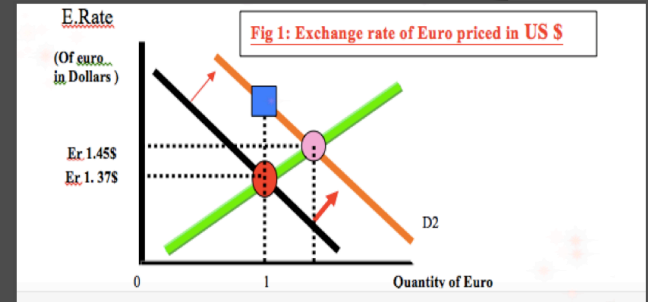
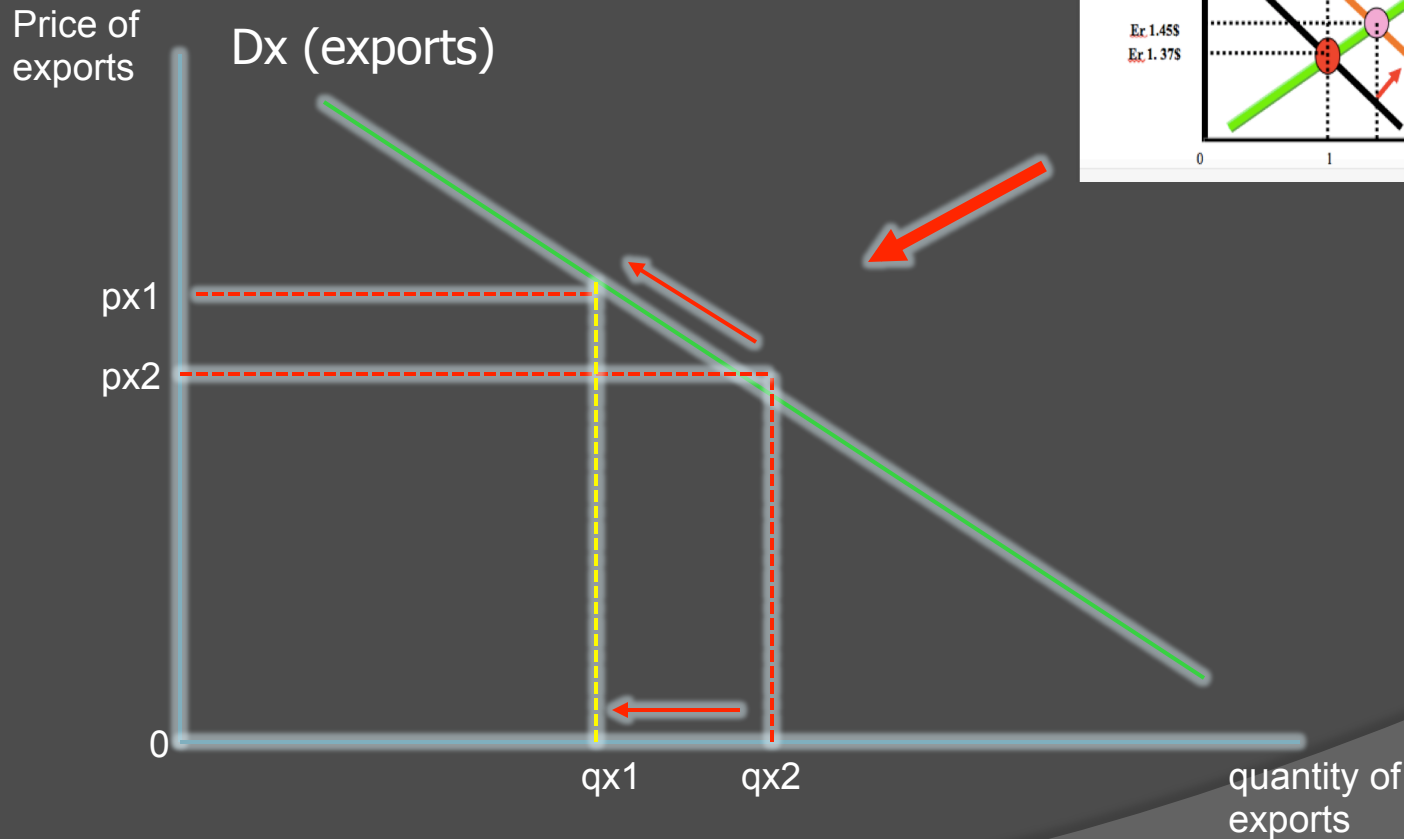
See webnote 321

# Demand

Demand for  
a currency:  
webnote 321



# Increase in $er$ for Euro causes a fall in demand for European exports



Increase in  $er$  of Euro from  $px_2$  to  $px_1$  causes a reduction in demand for European exports from  $qx_2$  to  $qx_1$ . Note in this case exports are price elastic. See Marshall Lerner condition in 3.3

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Syllabus reference: items 129 +132

Big Idea

2

**SUPPLY FOR A CURRENCY IS  
DETERMINED BY 3 FACTORS**

See web 322

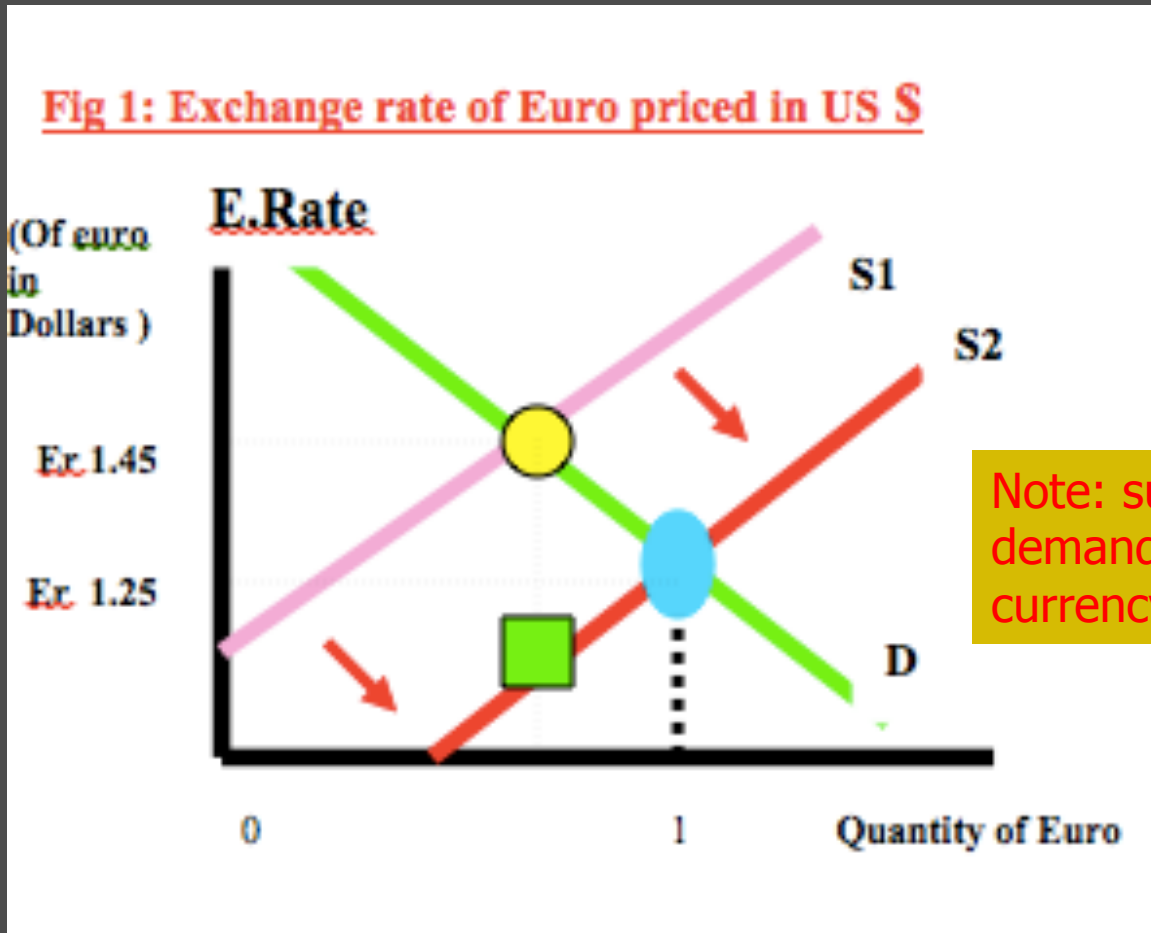
Supply determined by:

Speculation:  
see Soros  
story on  
webnote 323

1. **Save** (nationals save in a foreign country)
2. **Speculate** (by nationals abroad)
3. **Spend** (on foreign goods, **M** )

# Supply Label diagrams expertly!

See webnote  
321 + 322



Supply for a  
currency:  
webnote 322

Note: supply and demand of the currency is EURO

# Fall in **er** for Euro causes a rise in demand for European exports

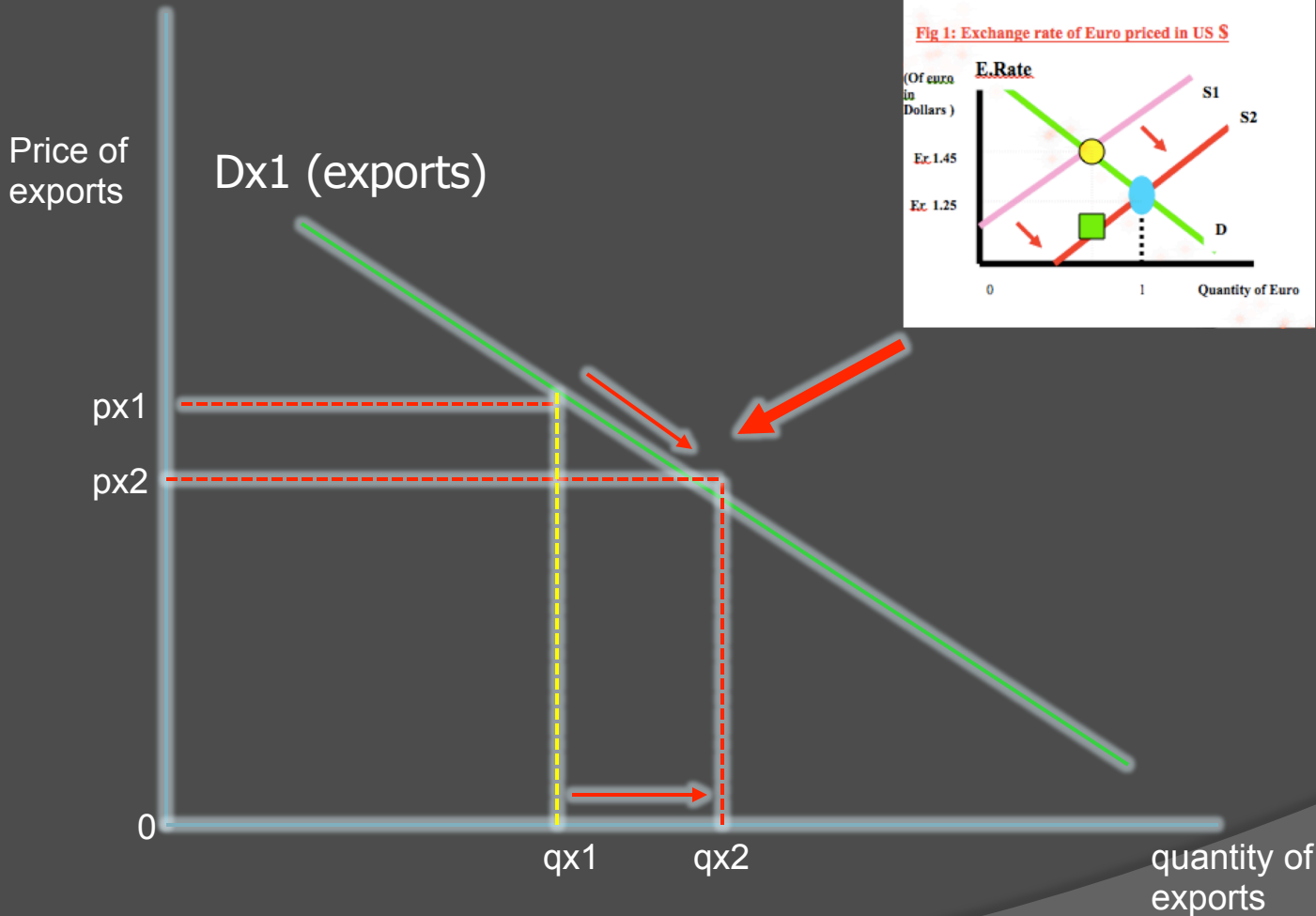
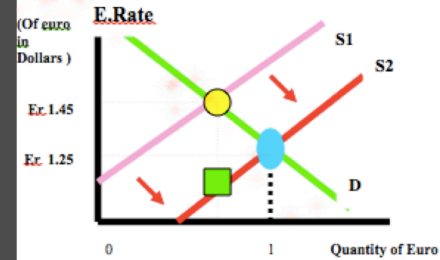


Fig 1: Exchange rate of Euro priced in US \$



Decrease in  $er$  of Euro from  $px_1$  to  $px_2$  causes an increase in demand for European exports from  $qx_1$  to  $qx_2$



Big Idea

3

Supply and Demand for a currency is not only imports and exports but all flows of money

Demand - in	Supply - out
Exports – money in	Imports – money out
FDI	FDI
Government and Private transfers of money into the domestic country	Government and Private transfers of money out of the domestic country
Tourism (into domestic nation)	Tourism (out of domestic nation)

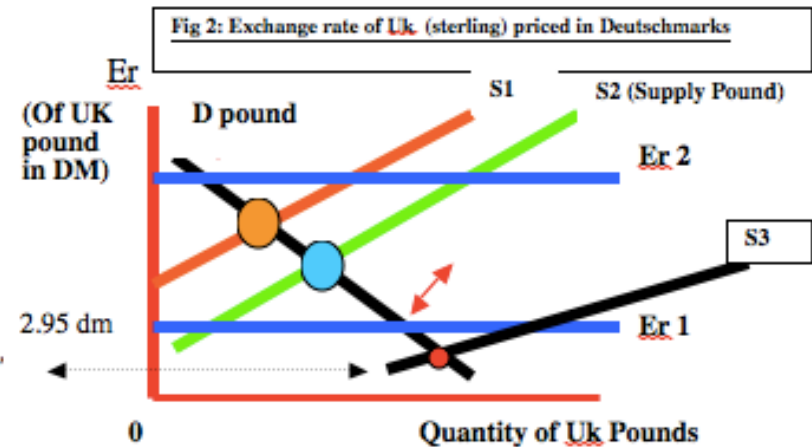
# Fixed – Semi Fixed – Dirty Float – Managed Exchange Rates

See webnote 323

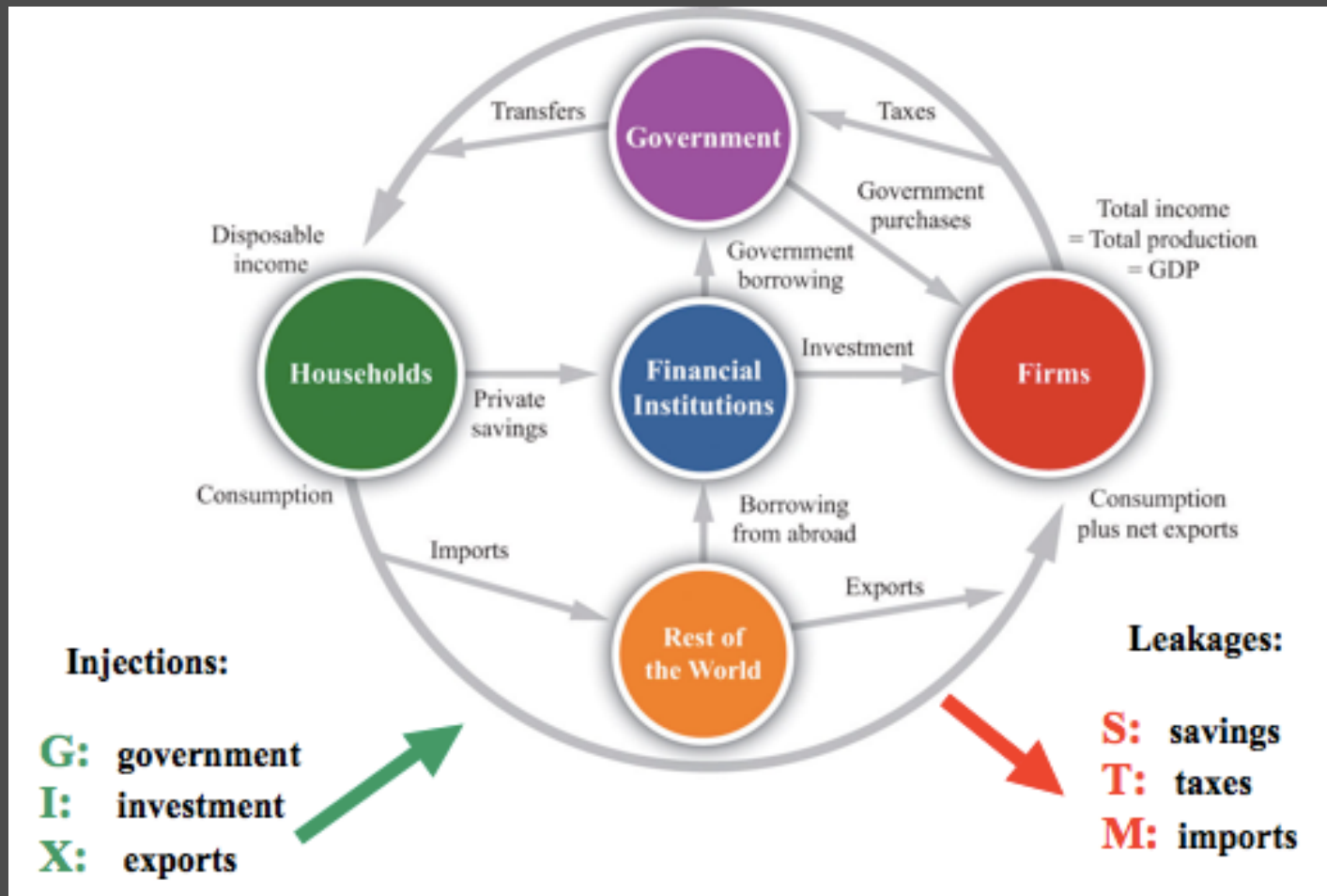
## Important definitions:

- Fixed exchange rate  
Appreciation/depreciation
- Flexible/floating exchange rate  
Managed/dirty float/semi-fixed  
exchange rate/pegged system  
Revaluation/devaluation

Note: supply and demand of the currency is UK pounds



# Useful diagram – injections+ leakages circular flow of income



# Big Questions for webnote 99

## 3.2 Exchange rates Big Questions:

1. What determines exchange rates?
2. How do exchange rates affect the economy?

# Ib question May 2013 - HP1

International Trade

- ◎ SL paper 2 2010-May
- ◎ **4d Using information from the text/data and your knowledge of economics, evaluate the impact of a rising currency on the Indian economy. 8/20 marks**
- ◎ HL 2 2009-May
- ◎ **4. (c) Using an appropriate diagram, how an increase in foreign direct investment can lead to an appreciation of the Indian rupee. 4/20 marks**

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- ⦿ Reading:
- ⦿ See Blink pp 282-293
- ⦿ AAA

⦿ End