11.2 Exchange rates

Name: ____________ Class: ________ Date: __________ **Total: 27 marks**

KEY WORDS revaluation 法定升值 • exchange rates 汇率 • devaluation 法定贬值 • nominal 名义 • real 实际

Objective

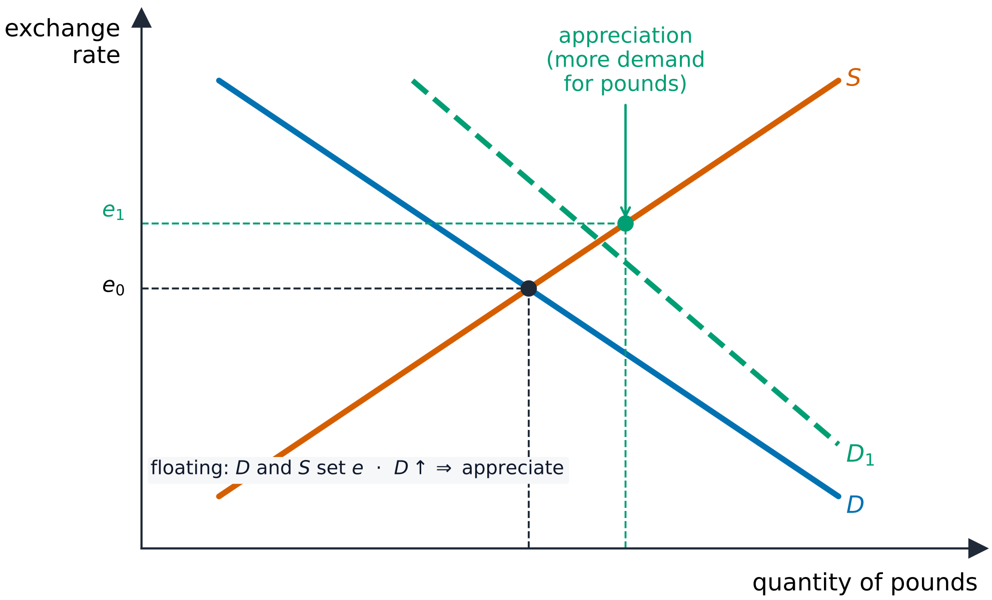
Build the skills to answer exam questions on **exchange rates** 汇率 at A Level — the **nominal, real and effective** 名义、实际、有效 exchange rate, the three systems, and **appreciation, depreciation, revaluation and devaluation** 升值、贬值、法定升值、法定贬值.

You must be able to:

- distinguish nominal, real and trade-weighted (effective) exchange rates
- describe floating, fixed and managed systems
- analyse the effects of a change in the exchange rate

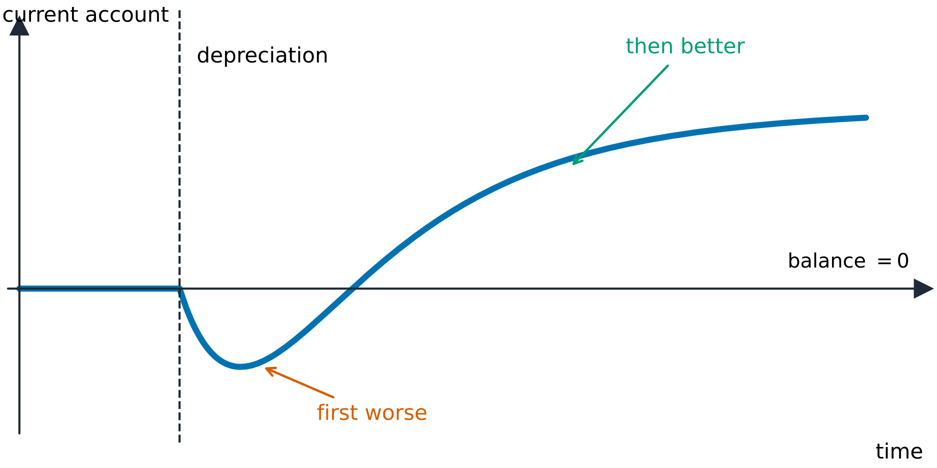
1 Worked examples

■ Measuring and changing the rate



More demand for the currency raises its value — an appreciation

- **Nominal** 名义: the everyday market rate. **Real** 实际: adjusted for price differences (true competitiveness). **Effective/trade-weighted** 有效: an average against all trading partners.
- **Systems:** floating, fixed, managed.
- Floating: **appreciation** 升值 / **depreciation** 贬值. Fixed: **revaluation** 法定升值 / **devaluation** 法定贬值.



J-curve: after depreciation, CA first worse then better

A rate change takes time to bite: the J-curve traces the trade balance afterward

Answer shapes: an **Explain** [**up to 8**] answer may use a currency diagram (AO3); **Discuss** [**12**] adds a judgement (AO4).

2 Practice

2.1 State the difference between the *nominal* and the *real* exchange rate. [2]

2.2 Define the term *effective (trade-weighted) exchange rate.* [2]

2.3 State the difference between a *depreciation* and a *devaluation.* [2]

3 Exam-style questions

3.1 Under a **fixed** exchange-rate system, a deliberate fall in the currency's value is a: [1]

- **A** depreciation
- **B** appreciation
- **C** devaluation
- **D** revaluation

3.2 Using a currency demand and supply diagram, explain how a fall in demand for a country's exports affects its floating exchange rate. [8]

3.3 Discuss whether a fixed exchange rate is better than a floating exchange rate. [12]

Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

2.1 the nominal rate is the everyday market rate between two currencies; the real rate adjusts it for differences in prices, showing true competitiveness (2 for a clear difference; 1 for a partial idea).

2.2 an average of a currency's value against all its trading partners, weighted by how much trade is done with each (2 for a clear definition; 1 for a partial idea).

2.3 a depreciation is a fall in value under a floating system (set by the market); a devaluation is a deliberate fall under a fixed system (set by the central bank) (2 for a clear difference; 1 for a partial idea).

3.1 C. A deliberate fall under a fixed system is a devaluation.

3.2 *[8]* AO1 1 + **AO3 diagram up to 4** (demand for the currency shifts left, rate falls) + AO2/AO3 up to 3 — fewer exports sold means foreigners need less of the currency → demand for it shifts left → with supply unchanged the exchange rate falls (a depreciation).

3.3 *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **Fixed:** gives certainty for traders and investors and disciplines inflation — but needs large reserves and removes monetary independence. **Floating:** adjusts automatically and frees monetary policy — but can be volatile and speculative. Judgement: neither is always better — a fixed rate suits a country seeking stability and credibility, a floating rate one wanting policy freedom; it depends on the economy's needs.