# Past-paper walk-through

## Foreign exchange rates ▪ 6.3

eXercise

# Questions in this set

- 0455/11 N25 Q29 ▪ 1 mark
- 0455/11 N25 Q30 ▪ 1 mark
- 0455/13 N25 Q20 ▪ 1 mark
- 0455/11 J25 Q29 ▪ 1 mark
- 0455/12 J25 Q29 ▪ 1 mark
- 0455/13 J25 Q29 ▪ 1 mark
- 0455/11 N24 Q29 ▪ 1 mark
- 0455/13 N24 Q29 ▪ 1 mark
- 0455/22 N24 Q3 ▪ 20 marks

# Reading the mark scheme

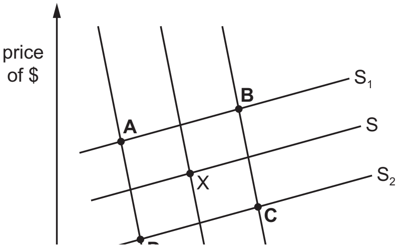
- **B1** a mark that stands on its own – the point is either made or not.
- **M1** a *method* mark: the right approach, even if the number is wrong.
- **A1** an *answer* mark, and it usually needs its M mark first.
- **C1** a working mark on the way to the answer.
- // separates answers the examiner accepts equally.
- **ecf** = error carried forward: a later part is marked on your own earlier answer.
- **owtte** = "or words to that effect" – the wording need not match.

# Question 29

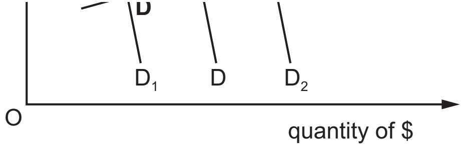
0455/11 N25 ▪ Q29 ▪ 1 mark

**29** The US currently trades in oil with the UK. The discovery of new oil and gas deposits in the US will mean that its oil imports decrease and its oil exports increase.

From the initial equilibrium point of X, which letter indicates the new equilibrium point for the US exchange rate?



# Question 29



# Solution 29

Answer: **B**

**Why**

- If US oil imports fall and exports rise, the US buys less foreign currency and earns more.
- So the US current account improves.
- The UK, on the other side of that trade, sells less oil to the US, so its export earnings fall.

# Question 30

0455/11 N25 ▪ Q30 ▪ 1 mark

**30** What is most likely to directly result from a persistent and large current account surplus on the balance of payments of a country?

**A** a lower exchange rate

**B** a lower standard of living

**C** an increase in gross domestic product

**D** an increase in the unemployment rate

# Solution 30

Answer: **C**

## Why

- A persistent current account surplus means strong demand for the country's currency.
- That pushes the exchange rate *up*, not down.
- A higher exchange rate then makes exports dearer, which eventually erodes the surplus.

# Question 20

0455/13 N25 ▪ Q20 ▪ 1 mark

**20** Which combination of policy measures is most likely to increase total demand in an economy?

| | money supply | interest rate | exchange rate |
|---|---|---|---|
| **A** | decrease | decrease | revaluation |
| **B** | decrease | increase | devaluation |
| **C** | increase | decrease | devaluation |
| **D** | increase | increase | revaluation |

# Solution 20

Answer: **C**

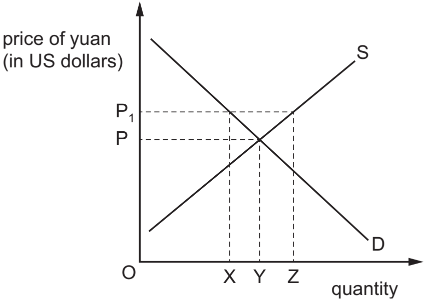
**Why**

- Total demand rises when spending becomes cheaper or more money is available.
- So a lower interest rate, a larger money supply and a devalued exchange rate all raise it.
- A revaluation would make exports dearer, reducing demand.

# Question 29

0455/11 J25 ▪ Q29 ▪ 1 mark

**29** In the diagram, D is the demand curve for the Chinese yuan and S is the supply curve of the Chinese yuan.



# Question 29

The Chinese central bank wishes to set the price of the yuan at $P_1$.

Which action would it have to take?

**A** buy XY yuan

**B** buy XZ yuan

**C** sell XY yuan

**D** sell XZ yuan

# Solution 29

Answer: **B**

**Why**

- The exchange rate is set where demand for the currency meets supply of it.
- More foreigners buying Chinese goods raises demand for yuan, so the yuan appreciates.
- More Chinese buying imports raises the supply of yuan, so it depreciates.

# Question 29

0455/12 J25 ▪ Q29 ▪ 1 mark

**29** The table shows the retail price at which the same book can be bought in four countries.

| country | price in local currency | local currency |
|---|---|---|
| Australia | $14.99 | Australian dollars |
| Canada | $11.99 | Canadian dollars |
| New Zealand | $20.95 | New Zealand dollars |
| United Kingdom | £6.99 | GB pound |

What additional information is required to make a meaningful comparison of the price of the book between the countries?

**A** direct tax rates

# Question 29

**B** exchange rates

**C** inflation rates

**D** level of import tariffs

# Solution 29

Answer: **B**

**Why**

- To compare prices across countries, convert them all into one currency.
- Use each country's exchange rate to express the price in a common unit.
- Only then can the four figures be ranked meaningfully.

# Question 29

0455/13 J25 ▪ Q29 ▪ 1 mark

**29** The table shows the value of the UK pound (£) against the US dollar ($) in June and September.

| June | September |
|---|---|
| £1 = $1.48 | £1 = $1.32 |

What will be the likely consequence for the UK economy in the short run of the change in the exchange rate?

**A** an increase in the budget deficit

**B** an increase in the price of exports

**C** an increase in the price of imports

**D** an increase in unemployment

# Solution 29

Answer: **C**

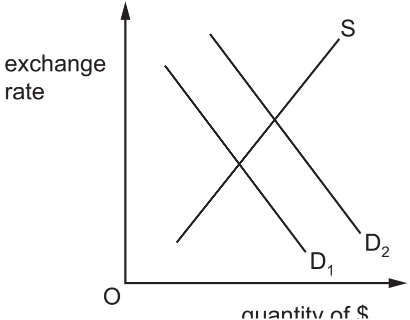
**Why**

- Sterling moved from \$1.48 to \$1.32, so the pound has *depreciated*.
- That makes UK exports cheaper for American buyers and US imports dearer in Britain.
- So export volumes should rise and import volumes fall.

# Question 29

0455/11 N24 ▪ Q29 ▪ 1 mark

**29** The diagram shows the change in the exchange rate market for country X's $.



# Question 29

quantity of \$

Which change in country X would have caused this?

**A** a fall in its international competitiveness

**B** a fall in its level of interest rates

**C** a rise in its exports of services

**D** a rise in its imports of goods

# Solution 29

Answer: **C**

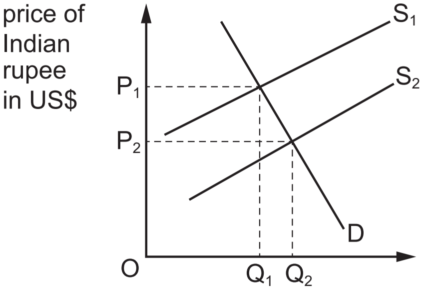
**Why**

- The diagram shows the demand for country X's currency shifting.
- Demand rises when foreigners want more of X's exports or want to invest there.
- Demand falls when its exports become less attractive, so the exchange rate falls.

# Question 29

0455/13 N24 ▪ Q29 ▪ 1 mark

**29** The diagram shows a change in the exchange rate for the Indian rupee against the US$.



# Question 29

quantity of
Indian rupees

What could cause the change in the exchange rate?

**A** a decrease in the rate of inflation in India

**B** an increase in demand for imports by people in India

**C** greater foreign direct investment into India

**D** greater purchases of its own currency by the Indian central bank

# Solution 29

Answer: **B**

## Why

- The exchange rate is set where demand for the rupee meets its supply.
- Read which curve shifted and in which direction.
- More demand for rupees raises the rate; more supply of rupees lowers it.

# Question 3

0455/22 N24 ▪ Q3 ▪ 20 marks

3 The central bank of Madagascar intervenes in the country's foreign exchange market. However, Madagascar has a largely market economic system. Nearly 70% of Madagascar's population live in poverty. Most of the country's industries are labour-intensive. In 2020, Madagascar had an economic growth rate of 6% and a deficit on the current account of its balance of payments of $0.6bn.

(a) Define foreign exchange market. [2]

(b) Explain two reasons why a firm may adopt labour-intensive production. [4]

(c) Analyse how the macroeconomic aims of economic growth and balance of payments stability may conflict. [6]

(d) Discuss whether or not a high level of poverty is likely to exist in a market economic system.
[8]

# Question 3

**(a)** (a) Define foreign exchange market. [2] **[2]**
**(b)** (b) Explain two reasons why a firm may adopt labour-intensive production. [4] **[4]**
**(c)** (c) Analyse how the macroeconomic aims of economic growth and balance of payments stability may conflict. [6] **[6]**
**(d)** (d) Discuss whether or not a high level of poverty is likely to exist in a market economic system. [8] **[8]**

# Solution 3

## (a)

**Mark scheme**

- Define foreign exchange market.
- An arrangement / place (1) where different countries'
- currencies are bought/demanded (1) and sold/supplied 1
- one currency is exchanged for another currency (1).
- 2

# Solution 3

## (b) Mark scheme

- Explain two reasons why a firm may adopt labour-
- intensive production.
- Logical explanation which might include:
- ▪
- Labour may be low in price / wages may be low 1
- which might make labour cheaper than capital / there
- may be a high supply of labour (1).
- ▪

# Solution 3

- Labour may be very productive / efficient (1) which can
- make employment profitable / result in low costs of
- production (1).
- ▪
- The government may subsidise the employment of
- workers (1) to reduce unemployment (1).
- ▪
- The firm may provide personal services (1) with
- individual attention (1).
- ▪

# Solution 3

- Labour may be more creative / adaptable / provide
- feedback (1) produce high quality products / improve
- methods of production [1]
- ▪
- Labour may be unskilled / low level of education [1]
- unable to use high-tech capital equipment (1).
- 4 One mark each for each of two reasons identified and one
- mark for each of two explanations.
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- October/November 2024

# Solution 3

- Guidance

# Solution 3

## (c) Mark scheme

- Analyse how the macroeconomic aims of economic
- growth and balance of payments stability may conflict.
- Coherent analysis which might include:
- Economic growth may increase employment (1) increase
- wages / incomes / purchasing power (1) this may increase
- imports (1).
- Higher consumer spending (1) may encourage firms to
- switch products to the domestic market (1) reduce exports

# Solution 3

- (1) increase / cause a current account deficit (1).
- To produce more goods and services, firms may import
- more raw materials (1) capital goods (1).
- Economic growth may result in inflation (1) which would
- make domestic products less price competitive (1).
- Economic growth may deplete resources (1) increase need
- for imports (1).
- Economic growth may be export-led (1) may be achieved by
- restricting imports (1) result in a current account surplus (1).
- Migrant workers may send more money home (1).

# Solution 3

- Export-led growth may increase the exchange rate (1) which
- may increase imports / reduce exports (1).
- 6
- 0455/22
- October/November 2024
- Guidance

# Solution 3

## (d) Mark scheme

- Discuss whether or not a high level of poverty is likely
- to exist in a market economic system.
- In assessing each answer, use the table opposite.
- Why it might:
- ▪
- may be unemployment
- ▪
- lack of welfare benefits

# Solution 3

- ▪
- likely to be income inequality
- ▪
- merit goods including healthcare and education may be
- under-consumed and so underproduced
- ▪
- monopolies may develop resulting in higher prices.
- Why it might not:
- ▪
- competition / profit motive may result in low prices

# Solution 3

- ▪
- efficiency is encouraged which can result in high wages
- and high employment
- ▪
- greater response to changes in consumer demand, may
- increase economic growth
- ▪
- countries with efficient private sector firms may have
- relative poverty but low absolute poverty.
- 8

# Solution 3

- Level
- Description
- 3
- A reasoned discussion which
- accurately examines both sides of the
- economic argument, making use of
- economic information and clear and
- logical analysis to evaluate economic
- issues and situations. One side of the
- argument may have more depth than

# Solution 3

- the other, but overall both sides of the
- argument are considered and
- developed. There is thoughtful
- evaluation of economic concepts,
- terminology, information and/or data
- appropriate to the question. The
- discussion may also point out the
- possible uncertainties of alternative
- decisions and outcomes.
- 6–8

# Solution 3

- 2
- A reasoned discussion which makes
- use of economic information and clear
- analysis to evaluate economic issues
- and situations. The answer may lack
- some depth and development may be
- one-sided. There is relevant use of
- economic concepts, terminology,
- information and data appropriate to
- the question.

## Solution 3

- 3–5
- 1
- There is a simple attempt at using
- economic definitions and terminology.
- Some reference may be made to
- economic theory, with occasional
- understanding.
- 1–2
- 0
- A mark of zero should be awarded for

# Solution 3

- no creditable content.
- 0
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