Summary

4.5 Exchange rates

Subject	Year	Start date	Duration
Economics	IB2	Week 3, January	1 week 2 hours

Course Part

4. The global economy

Description

4.5 Exchange rates, you should be able to:

- Define the following terms: forex, remittance, stakeholder, exchange rate, floating exchange rate, appreciation (currency), depreciation (currency), portfolio investment, revaluation (currency) , devaluation (currency), fixed exchange rate system, currency peg, outsourcing of jobs, managed float exchange rate system, speculation, foreign direct investment (FDI), inward FDI, outward FDI, inward portfolio investments, outward portfolio investments, purchasing power parity (PPP), foreign exchange reserves, overvalued currency, undervalued currency, Big Mac index, balance of trade, current account, living standards
- Explain how the value of an exchange rate in a floating system is determined by the demand for, and supply of, a currency.
- Distinguish between a depreciation of the currency and an appreciation of the currency.
- Draw a diagram to show the determination of exchange rates in a floating exchange rate system.
- Calculate the value of one currency in terms of another currency.
- Using exchange rates, calculate the price of a good in different currencies.
- Explain the factors that lead to changes in currency demand and supply.
- Draw diagrams to show changes in the demand for, and supply of, a currency.
- Calculate the changes in the value of a currency from a set of data.
- Evaluate the possible economic consequences of a change in the value of a currency.
- Use AD/AS curves to show potential consequences of changes in the exchange rate on the economy.
- Describe a fixed exchange rate system involving a commitment to a single fixed rate.
- Distinguish between a devaluation of the currency and a revaluation of the currency.
- Explain, using a diagram, how a fixed exchange rate is maintained.
- Explain how a managed exchange rate operates.
- Examine the possible consequences of overvalued and undervalued currencies.
- Explain, using a diagram, how a managed exchange rate system is determined and changed.

Inquiry & Purpose

Inquiry / Higher Order Questions

Type	Inquiry Questions
Skills-based	Methods a government uses to manage its exchange rate and why, for a chosen country

Curriculum

Objectives

Application and analysis (AO2)

Analyse how economic information is used effectively in particular contexts

Use and application of appropriate skills (AO4)

Interpret appropriate data sets

Use quantitative techniques to identify, explain and analyse economic relationships

Syllabus Content

Unit 4: The global economy

Real-world issue 1 - Who are the winners and losers of the integration of the world's economies?

4.5 Exchange rates

Floating exchange rates

Determination

Depreciation and appreciation of a currency

Diagram: showing the exchange rate determination and changes in equilibrium in a floating exchange rate system

Calculation: using exchange rates, the price of a good in different currencies

Changes in demand and supply for a currency—factors including:

foreign demand for exports

domestic demand for imports

inward/outward foreign direct investment

inward/outward portfolio investment

remittances

speculation

relative inflation rates

relative interest rates

relative growth rates

central bank intervention

Calculation: changes in the value of a currency from a set of data

Consequences of changes in the exchange rate on economic indicators, such as:

the inflation rate

economic growth

unemployment

the current account balance

living standards

Diagram: AD/AS curves to show potential consequences of changes in the exchange rate on the economy

Fixed exchange rate

Devaluation and revaluation of a currency

How fixed exchange rates are maintained

Diagram: showing how a fixed exchange rate is maintained

Managed exchange rates

Overvalued currencies

Undervalued currencies

Diagram: showing the exchange rate determination and changes in equilibrium in a managed exchange rate system

Fixed versus floating exchange rate systems (HL only)

Concepts

The increased **interdependence** of economies has benefits and costs.

• Increased economic integration may result in **efficiency**, welfare gains and improvements in **economic well-being** but the benefits may not result in **equity**.

ATL Skills

Approaches to Learning

Thinking

- In this unit, we will

help students to make their thinking more visible (for example, by using a strategy such as a thinking routine)

Developing IB Learners

Learner Profile

Knowledgeable

Thinkers