

Economics

Section II

40 marks

Attempt Questions 21–24

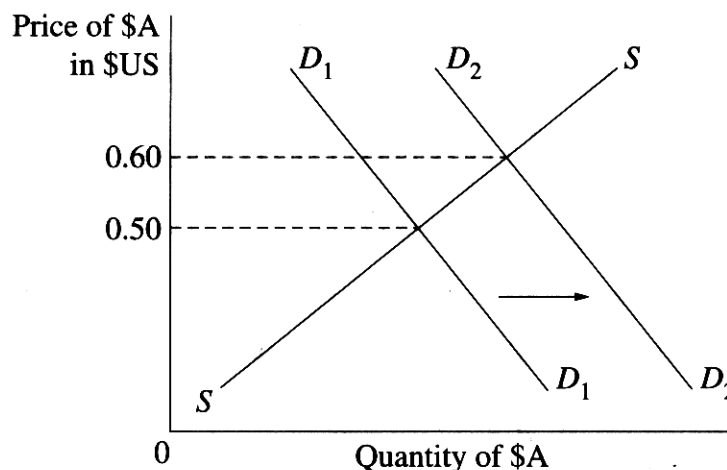
Allow about 1 hour and 15 minutes for this section

Answer the questions in the spaces provided.

Marks

Question 21 (10 marks)

The diagram shows information about the demand and supply of Australian dollars (\$A) in terms of United States dollars (\$US). Both countries have flexible exchange rates.



- (a) State the economic term given to the movement of the exchange rate of the \$A from \$US0.50 to \$US0.60. 1

..... *Appreciation*

- (b) Outline TWO causes of an increase in demand for \$A. 2

..... *Increased inflow of foreign investment*

..... *\$ speculation due to lower CAD*

..... *RBA has raised interest rates, making the Aust economy more attractive to investors & ↑ demand for \$A.*

Question 21 continues on page 10

Question 21 (continued)

- (c) Briefly explain how the Reserve Bank could intervene in the foreign exchange market to influence the exchange rate of the \$A. 3

The ~~RBA~~ ^{RBA} can ~~do~~ 'dirty the float' by ~~use~~ using the RBA's foreign reserves or gold to buy ~~\$A~~ (to \uparrow \$A) or sell ~~\$A~~ RBA's supply of \$A (to \downarrow \$A). Another way is use of monetary policy. RBA sells securities to banks to $i \uparrow$ & therefore attract ~~more~~ more foreign investors & therefore \uparrow demand of \$A. OR RBA can buy securities to $i \downarrow$, thus decreasing foreign investors, thus \downarrow demand of \$A.

- (d) Discuss TWO economic benefits to Australia of an appreciation of the \$A. 4

- Appreciation of \$A means that imports are cheaper, thus prices will fall, ~~reducing~~ reducing the inflationary pressures in the economy.
- Also, $\$A \uparrow$ reduces the value of Aust foreign ~~debt~~ debt (known as the 'valuation ~~effect~~ effect'), thus ~~improving~~ improving CAD. An improvement ~~in~~ in CAD ~~improves~~ improves Aust credit ratings, leading to \uparrow ~~foreign~~ ^{foreign} investors into Aust. economy.

End of Question 21