2002 HIGHER SCHOOL CERTIFICATE EXAMINATION

Economics

Section II

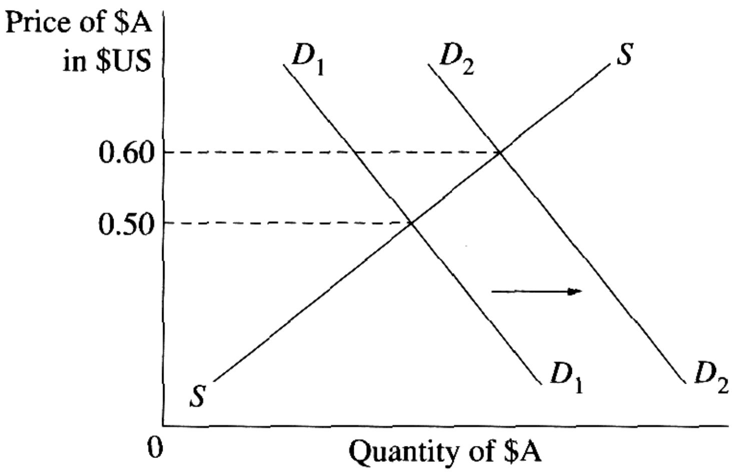
40 marks
Attempt Questions 21–24
Allow about 1 hour and 15 minutes for this section

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**

- Speculators may believe that the $A will appreciate and so buy more to make a profit.
- There may be an influx of tourists who have to exchange their money to $A

Question 21 continues on page 10

Marks

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 Reserve Bank could intervene indirectly through changes in interest rates. By tightening monetary policy it will create upward pressure on interest rates which will in turn ~~attract more~~ lower business investment as it is more expensive to borrow or vice versa with easing of monetary policy. The RBA can also directly become involved through 'dirtying' the float and becoming a buyer or seller of $A to influence demand and supply.

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

A higher $A means that any overseas loans ~~is~~ will become cheaper to service as the Australian dollar is worth more. This would reduce the value of net income on the balance of payments and could improve the current account deficit.
An appreciation of the $A means that imports will be cheaper. This allows consumers to have a wider range of products at lower prices.

End of Question 21