

Economics

Section II

40 marks

Attempt Questions 21–24

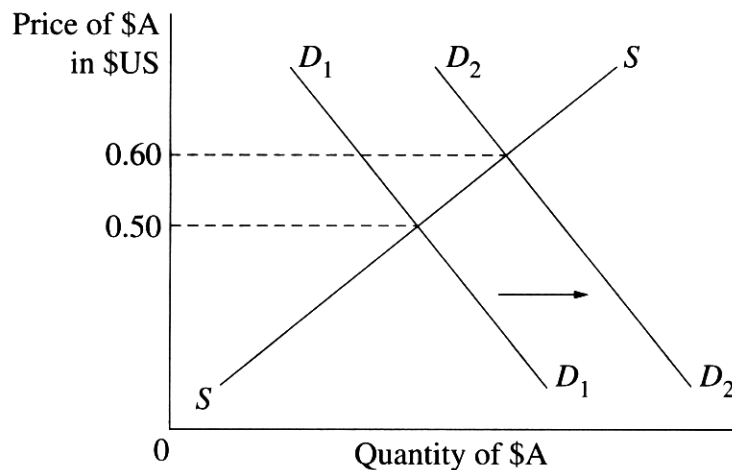
Allow about 1 hour and 15 minutes for this section

Answer the questions in the spaces provided.

Marks

Question 21 (10 marks)

The diagram shows information about the demand and supply of Australian dollars (\$) 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

If the demand for Australian exports increases then foreign customers will have to exchange their currency for \$AUD, therefore increasing the demand for Australian dollars. If speculators believe that the Australian dollar is about to appreciate they will buy more \$A hence increasing the 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 Reserve Bank could buy or sell \$A, which would affect the supply of Australian dollars. For example if the Reserve Bank wants to increase the value of \$A they will buy dollars, hence reducing supply, when supply decreases the price increases, hence the \$A will appreciate. If the Reserve bank wants to decrease the value of \$A they would ~~buy~~ ^{sell} \$A, hence increasing supply, when supply increases the price decreases, hence the \$A would depreciate.

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

When the \$A appreciates the value of the foreign debt in terms of \$A decreases, hence leading to a lower current account deficit, affecting the net incomes section of the current account thus decreasing the CAD.

When the \$A appreciates imports become cheaper, which means ~~an~~ Australians would have to pay less for imports. This would have an affect on the net goods section of the current account thus reducing the CAD.

End of Question 21