3.2 EXCHANGE RATES

I. TERMS & OBJECTIVES: FREELY FLOATING EXCHANGE RATES (SL/HL)

- Raw Material
- International Trade
- Foreign Direct Investment
- Portfolio Investment
- Foreign Reserves
- National Income
- Normal Goods
- Inflation
- Interest Rate
- Disequilibrium
- Consumer Surplus
- Costs of Production
- Aggregate Supply
- Price Level
- Productivity
- Average Total Cost
- Current Account Deficit
- Current Account Surplus
- Demand-Deficient Unemployment
- Aggregate Demand
- Deflationary Gap
- Capital (Goods)
- Substitutes
- Recession
- Cost-Push Inflation
- Price Inelastic
- Expenditure
- Purchasing Power
- Floating Exchange Rate System
- Currency Depreciation
- Currency Appreciation

1. Explain that the value of an exchange rate in a floating system is determined by the demand for, and supply of, a currency.
2. Draw a diagram to show determination of exchange rates in a floating exchange rate system.
3. Describe the factors that lead to changes in currency demand and supply, including foreign demand for a country's exports, domestic demand for imports, relative interest rates, relative inflation rates, investment from overseas in a country's firms (foreign direct investment and portfolio investment), and speculation.
4. Distinguish between a depreciation of the currency and an appreciation of the currency.
5. Draw diagrams to show changes in the demand for, and supply of, a currency.
6. Evaluate the possible economic consequences of a change in the value of a currency, including the effects on a country's inflation rate, employment, economic growth, and current account balance.