



BIG PICTURE IDEAS

- #1. Balance of **Payments** measures all international transactions in a year including exports and imports and the purchase and sale of **assets**, like bonds.
- #2. The value of one currency relative to a different currency is called the **exchange** rate.
- #3. A **demand** and **supply** graph can be used to explain changes in the foreign exchange market.
- #4. When a currency **appreciates**, exports decrease because products become more expensive for foreigners.
- #5. When interest rates **increase**, net capital inflow increases as foreigners buy more domestic assets, like bonds.

■ **Topic 6.1- Balance of Payments Accounts**

1. Balance of payment is made up of two accounts: the **current** account records net exports, income from abroad, and unilateral transfers and the **capital and financial** account records the international purchase and sales of assets.

2. Define net exports (XN). **The difference between a nation's exports of goods and services and imports of goods and services**

3. A trade **surplus** is when exports are greater than imports.

4. A trade **deficit** is when exports are less than imports.

True or False

5. When cars produced in Mexico are sold in the US the transaction is recorded in the current account as a credit for the US. **False (Debit not a credit)**

6. Identify if each transaction is included in the current account (CA) or the financial/capital account (CFA) for the US:

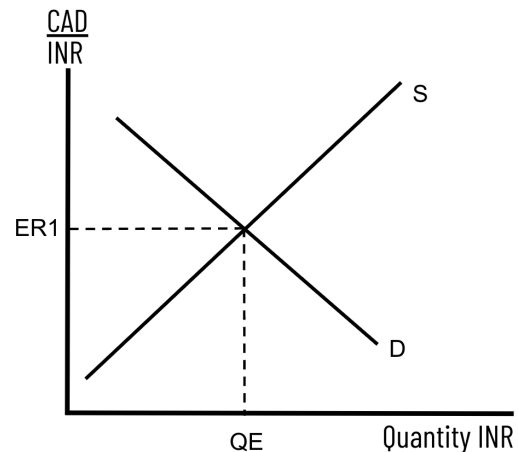
Transaction	Current Account	Financial Account
A Canadian buys lumber in the US.	✓	
An American buys a beach resort in Mexico.		✓
A Chinese company sells toys in the US.	✓	
An immigrant living in the US sends a portion of his earnings to his family overseas.	✓	
An American on vacation buys Japanese treasury bonds.		✓
An American company sells cars in the US.	Neither	

■ **Topic 6.2- Exchange Rates**

- 7. A country's currency **appreciates** when the value increases relative to the value of a foreign currency.
- 8. A country's currency **depreciates** when the value decreases relative to the value of a foreign currency.
- 9. True or False: Two currencies can both appreciate relative to each other at the same time. **False. One must appreciate and the other must depreciate**
- 10. Assume it now takes 100 yen to purchase 1 US dollar instead of 120 yen. Which currency appreciated and which currency depreciated? **The yen appreciated, the dollar depreciated**
- 11. Assume 1 US dollar went from equaling .9 euros to equaling 1 euro. Which currency appreciated and which currency depreciated? **The dollar appreciated, the euro depreciated**
- 12. If 1 US dollar equals 20 Mexican pesos, 1 peso equals how many dollars? **1 peso equals 0.05 US dollars. $1 / 20 = 0.05$**

■ **Topic 6.3- The Foreign Exchange Market**

13. Draw the foreign exchange market for Indian rupees (INR) relative to Canadian dollars (CAD) and label the equilibrium exchange rate ER1.



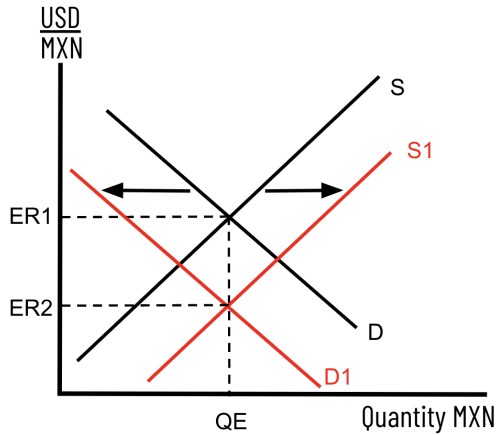
14. In most cases, people from **India** supply rupees and people from **Canada** demand rupees.



■ Topic 6.4- Changes in the Foreign Exchange Market 📺 🔊

15. What are the four shifters of demand and supply in the foreign exchange market? **Preferences, Income, Price level, Interest Rates**

16. Draw the foreign exchange market for Mexican pesos (MXN) relative to US dollars (USD) and show what will happen if inflation increases in Mexico? **Showing one shift is also correct**



17. Will the peso appreciate or depreciate? **Depreciate**

6. For each scenario, identify if the dollar and yen will appreciate (APP) or depreciate (DEP).

Scenario	Dollar	Yen
The US economy experiences rapid growth causing incomes to increase.	Dep	App
The US government places high tariffs on goods made in Japan.	App	Dep
The central bank of Japan sells bonds and increases Japanese interest rates.	Dep	App
Inflation in Japan rises significantly faster than in the US.	App	Dep
Real interest rates in the US decrease compared to Japan	Dep	App
Americans buy significantly more goods produced in Japan.	Dep	App

■ Topic 6.5- Foreign Exchange and Net Exports 🔊

Use arrows (↑ or ↓) to complete the following:

18. The US dollar will appreciate relative to another currency if the demand for the dollar ↑ or if the supply of the dollar ↓. This will cause US exports to ↓ and imports to ↑.

19. The US dollar will depreciate relative to another currency if the demand for the dollar ↓ or if the supply of the dollar ↑. This will cause US exports to ↑ and imports to ↓.

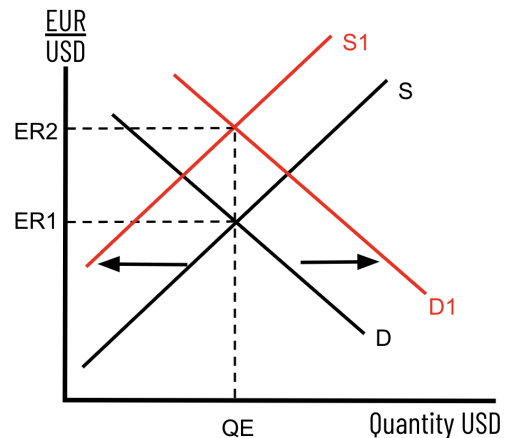
■ Topic 6.6- Real Interest Rates and International Capital Flows 🔊

20. A change in the real **interest** rate shifts both the demand and supply in the foreign exchange market.

21. Why does an increase in the real interest rate cause an increase in net capital inflow? **When interest rates are higher, foreigners want to buy more domestic assets, like bonds, because they provide a higher rate of return**

22. Will a decrease in the real interest rate move a country's capital/financial account (CFA) toward a deficit or toward a surplus? Explain. **Toward a deficit. A lower real interest rate would cause foreigners to purchase less domestic financial assets and decrease net capital inflow**

23. Draw the foreign exchange market for the US dollar relative to the euro and show what happens if real interest rates increase in the US.



24. Will the dollar appreciate or depreciate? **Appreciate**

📺 ←Easter Egg