Macroeconomics Unit 6 Study Guide
International Trade/Finance

MACROECONOMICS URP
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Topic 6.1- Balance of Payments Accounts

1. What do balance of payments (BOP) accounts measure? The BOP accounts measure all international transactions in a year. This includes the sale and purchase of goods/services and assets

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

3. What is the difference between the current account (CA) and the financial/capital account (CFA)? The CA measures records net exports, income from abroad, and unilateral transfers and the CFA records the purchase and sales of assets

4. A trade deficit is when __imports__ are greater than_exports_

5. A trade surplus is when __exports__ are greater than _imports

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

6. A US company sells jets in Canada. CA
7. An American buys a beach resort in Mexico. CFA
8. An American on vacation buys Japanese treasury bonds. CFA
9. A Chinese company sells toys in the US. CA
10. An immigrant living in the US sends a portion of his earnings to his family overseas. CA
11. An American company sells cars in the US. Neither
12. A Canadian buys lumber in the US. CA

Topic 6.2- Exchange Rates

1. What is the difference between appreciation and depreciation? Appreciation is when the value of a country's currency increases relative to a foreign currency. Depreciation is when the value of a country's currency falls.

2. Why can't two currencies both appreciate relative to each other at the same time? Exchange rates between countries are reciprocals of each other. If one currency appreciates, the other currency must depreciate.

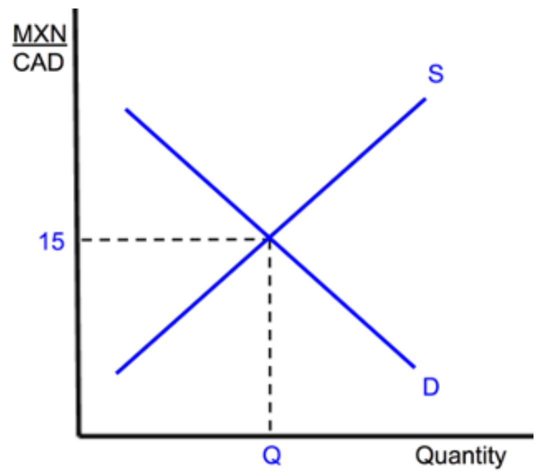
3. Assume it now takes 100 yen to purchase 1 US dollar instead of 120 yen. Which currency appreciated and which currency depreciated? The yen appreciated, the dollar depreciated

4. 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

5. If 1 US dollar equals 19 Mexican pesos, 1 peso equals how many dollars? 1/19 or .053 dollars

Topic 6.3- The Foreign Exchange Market

1. Draw a foreign exchange market for Canadian dollars (CAD) relative to Mexican pesos (MXN) with an equilibrium exchange rate at 15 pesos



2. Why is the demand for CAD downward-sloping? When the exchange rate increases, Mexicans are willing and able to buy less Canadian dollars. When the rate falls, Mexicans buy more.

3. Why is the supply for CAD upward-sloping? When the exchange rate increases, Canadians are willing and able to supply more dollars. When the rate falls, Canadians supply less.

Topic 6.4- Changes in the Foreign Exchange Market

1. What are the four shifters of demand and supply in the foreign exchange market? A change in tastes and preferences, change in domestic income, change in domestic inflation, change in real interest rates

2. Which shifters shift both the demand and the supply of a currency at the same time? Explain. Change in domestic inflation and change in real interest rates. These affect the behavior of both buyers and sellers of currency

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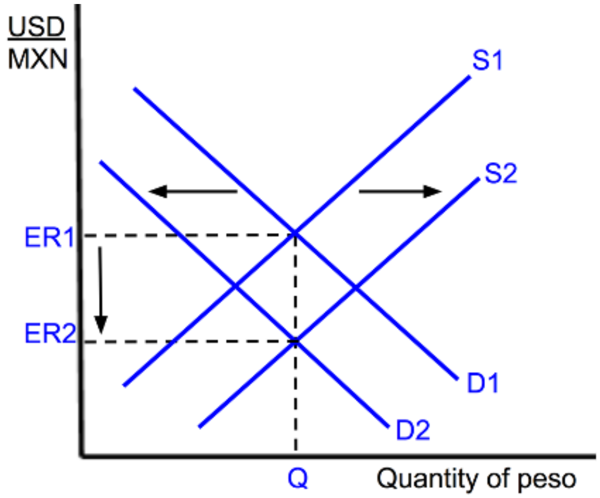
Topic 6.4- Changes in the Foreign Exchange Market (continued)

3. Draw the foreign exchange market for Mexican pesos (MXN) relative to US dollars (USD). What happens if inflation increases in Mexico?



4. Will pesos appreciate or depreciate? Depreciate

5. Will dollars appreciate or depreciate? Appreciate

6. If American tourists increase visits to Japan, the supply of US dollars will __increase__ and the demand for Japanese yen will __increase__. The dollar will __depreciate__. The yen will __appreciate__.

7. If the US economy experiences rapid growth, incomes in the Us will increase, the US dollar will __depreciate__ and the yen will __appreciate__.

8. If inflation in Japan rises significantly faster than in the US, the US dollar will __appreciate__ and the yen will _depreciate_

9. If the central bank of Japan sells bonds and increases Japanese interest rates, the US dollar will __depreciate__ and the yen will __appreciate__.

10. If Japan places tariffs on US imports, the dollar will __depreciate__ and the yen will __appreciate__.

11. The US suffers a larger recession causing incomes to fall, the dollar will __appreciate__ and the yen will __depreciate_.

Topic 6.5- Foreign Exchange and Net Exports

1. If a country's currency appreciates, net exports will __decrease__.
2. If a country's currency depreciates, net exports will __increase__.
3. The US dollar will appreciate relative to another currency if the demand for the dollar __increases__ or if the supply of the dollar __decreases__. This will cause US exports to __decrease__ and imports to __increase__.
4. The US dollar will depreciate relative to another currency if the demand for the dollar __decreases__ or if the supply of the dollar __increases__. This will cause US exports to __increase__ and imports to __decrease__.

Topic 6.5- Real Interest Rates and International Capital Flowss

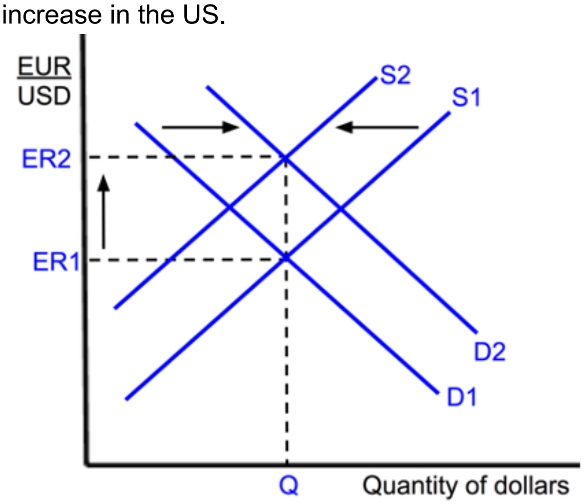
1. What is net capital inflow? The difference between the amount of money coming into a country to buy domestic assets and the amount of money leaving a country to buy foreign assets

2. 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

3. 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

4. Why does an increase in the real interest rate shift both the demand and the supply for currency? When the interest rate is high, foreigners demand more of the currency so they can buy assets while those in the country supply less of the currency

5. 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.



6. Will the dollar appreciate or depreciate? Appreciate
7. Will the euro appreciate or depreciate? Depreciate
8. Will the supply of loanable funds in the US increase or decrease? Increase (more savings)