Exchange rates

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Nominal exchange rates

The nominal foreign exchange rate is the price of one currency in terms of another currency; that is, the price of the domestic currency in terms of a foreign currency.

All exchange rates that you see quoted in the newspapers, on television or the Internet, or at travel agents, banks or airports, are nominal rates.

If a company trades overseas, it will buy or sell assets in foreign currencies. For example, an American company might buy materials from Canada, and pay for them in US dollars, and then sell its finished goods in Germany, receiving payment in Euros, or perhaps in some other currency.

Example!

Trade weighted exchange rate

A trade-weighted exchange rate is a measure, in index form, of the value of a currency against a basket of currencies. These are weighted according to the relative importance of the countries in the country's trade.

Real effective exchange rate

A real effective exchange rate is a country's exchange rate adjusted for changes in the domestic currency prices of its exports relative to the foreign currency prices of its imports.

If a country's prices rise (fall) relative to those of its trading partners, its real exchange rate will rise (fall) relative to the nominal exchange rate

$$\text{The real exchange rate} = \frac{\text{nominal exchange rate} \times \text{domestic price index}}{\text{foreign exchange rate}}$$

Floating exchange rate system

Floating exchange rates are exchange rates that are allowed to fluctuate according to demand and supply conditions in the foreign exchange markets.

A genuine free float would involve leaving exchange rates entirely to the vagaries of **supply and demand on the foreign exchange markets**, and neither intervening on the market using official reserves of foreign exchange nor taking exchange rates into account when making interest rate decisions.

Appreciation

A rise in the value of the currency caused by...

...an increase in demand...
...a decrease in supply...

is known as an appreciation.

Depreciation

A fall in the value of a currency caused by...

...a fall in demand...
...a decrease in supply...

is known as depreciation.

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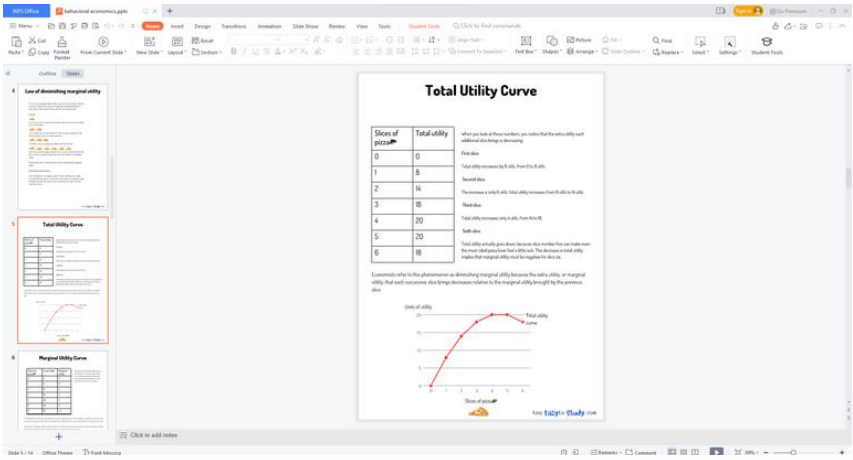

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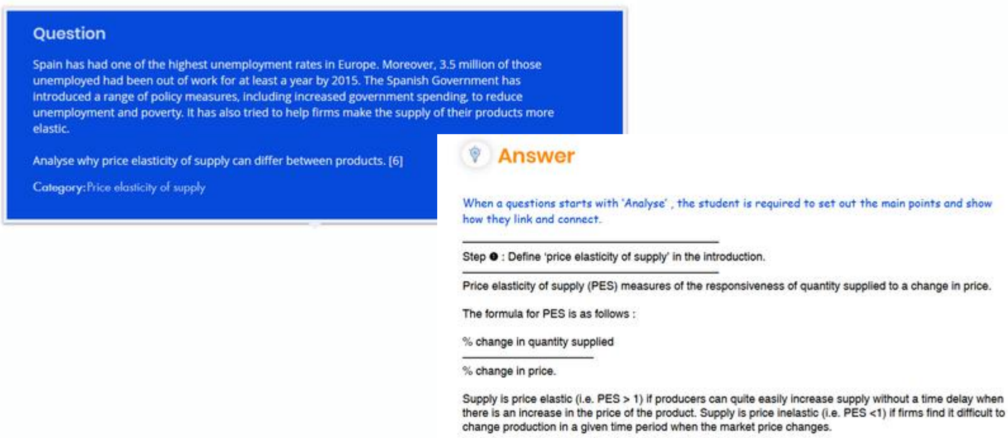

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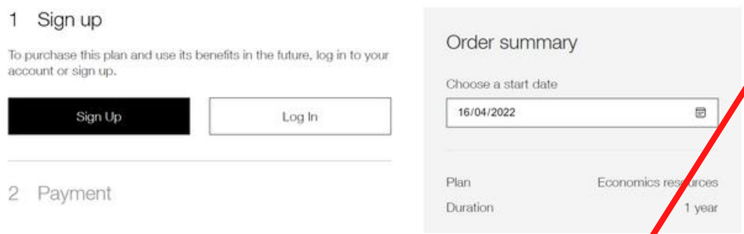

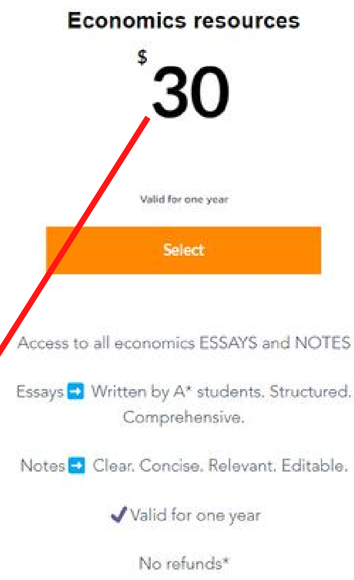

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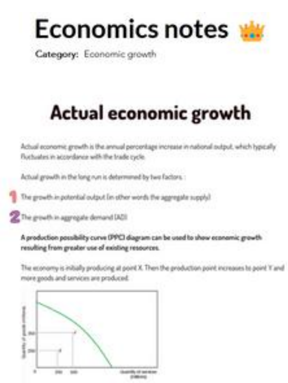

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FREQUENTLY ASKED QUESTIONS

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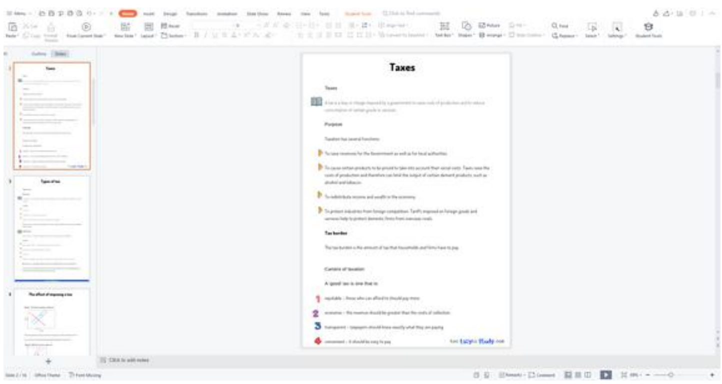
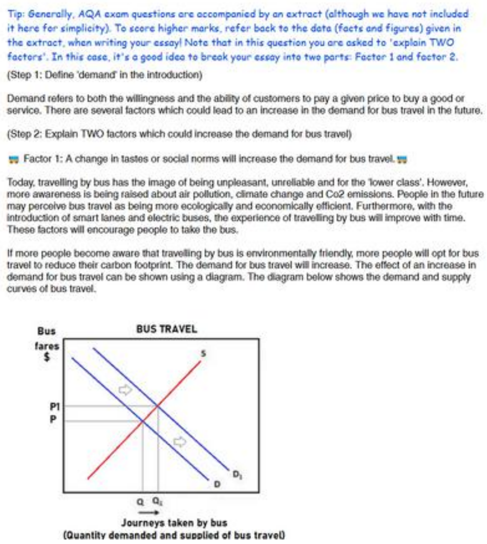


2. We know writing economics essays can be a struggle, especially during an exam, during which time is limited.

- That's why we've structured every essay in an optimal way and broke every essay down into headings and paragraphs. We've even included tips and marking scheme comments!



Tip: Generally, AQA exam questions are accompanied by an extract (although we have not included it here for simplicity). To score higher marks, refer back to the data (facts and figures) given in the extract, when writing your essay! Note that in this question you are asked to 'explain TWO factors'. In this case, it's a good idea to break your essay into two parts: Factor 1 and factor 2.

(Step 1: Define 'demand' in the introduction)

Demand refers to both the willingness and the ability of customers to pay a given price to buy a good or service. There are several factors which could lead to an increase in the demand for bus travel in the future.

(Step 2: Explain TWO factors which could increase the demand for bus travel)

Factor 1: A change in tastes or social norms will increase the demand for bus travel.

Today, travelling by bus has the image of being unpleasant, unreliable and for the 'lower class'. However, more awareness is being raised about air pollution, climate change and Co2 emissions. People in the future may perceive bus travel as being more ecologically and economically efficient. Furthermore, with the introduction of smart lanes and electric buses, the experience of travelling by bus will improve with time. These factors will encourage people to take the bus.

If more people become aware that travelling by bus is environmentally friendly, more people will opt for bus travel to reduce their carbon footprint. The demand for bus travel will increase. The effect of an increase in demand for bus travel can be shown using a diagram. The diagram below shows the demand and supply curves of bus travel.