AP Macroeconomics
Welker

<u>Balance of Payments and Exchange Rates</u>

Quiz - 19 points

1. Assume that yesterday the exchange rate between the euro and the Singaporean dollar was 1 euro = 0.58 Singaporean dollars. Assume that today the euro is trading at 1 euro = 0.60 Singaporean dollars.
    a. How will the change in the exchange rate affect each of the following in Singapore in the short run?
        i. Aggregate demand. Explain. **(2 points)**
        ii. The level of employment. Explain. **(2 points)**
    b. Suppose that Singapore wants to return the exchange rate to 1 euro = 0.58 Singaporean dollars.
        i. Should the Singaporean central bank buy or sell euros in the foreign exchange market? **(1 point)**
        ii. Instead of buying or selling euros, what domestic open-market operation can the Singaporean central bank use to achieve the same result? Explain. **(2 points)**

2. Balance of payments accounts record all of a country's international transactions during a year.
    a. Two major sub-accounts in the balance of payments accounts are the current account and the financial (sometimes called capital) account. In which of these sub-accounts will each of the following transactions be recorded?
        i. A United States resident buys chocolate from Belgium. **(1 point)**
        ii. A United States manufacturer buys computer equipment from Japan. **(1 point)**
    b. How would an increase in the real income in the United States affect the United States current account balance? Explain. **(2 points)**
    c. Using a correctly labeled graph of the foreign exchange market for the United States dollar, show how an increase in United States firms' direct investment in India will affect the value of the United States dollar relative to the Indian currency (the rupee). **(2 points)**

3. Assume that the real interest rate in both the United States and the European Union equals 4.5%.
    a. Assume that the real interest rate in the United States falls to 3.75%.
        i. How will the flow of financial capital between the US and the EU be affected? Explain. **(2 points)**
        ii. Using a correctly labeled graph of the foreign exchange market for the euro, show how the value of the euro would change relative to the US dollar in a flexible exchange rate system. **(2 points)**
    b. Explain how the change in the value of the euro in part (a) (ii) would affect the European Union's net exports. **(2 points)**