

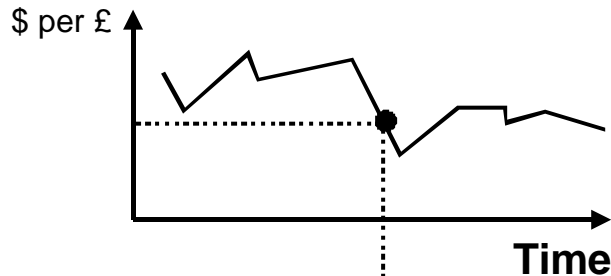
# Exchange Rates

- 1
- The **exchange rate** is the price of one currency in terms of another. It can be quoted in two ways. Example: In London, the USD is quoted as follows: 1 GBP = 1.6 USD. It could as well be quoted as follows: 1 USD = 0.625 GBP.
  - There are two different exchange rate systems: **Flexible (floating) exchange rates** and **fixed exchange rates**.

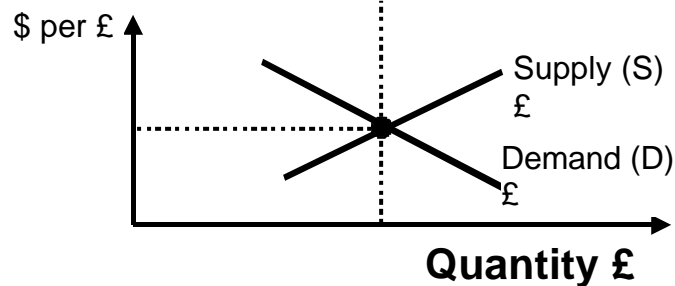
2 **Flexible exchange rates** are determined by market forces. There are no interventions by the Government. We look at exchange rate USD per GBP in London.

## 21 Flexible exchange rate

Fluctuations during a **time period**



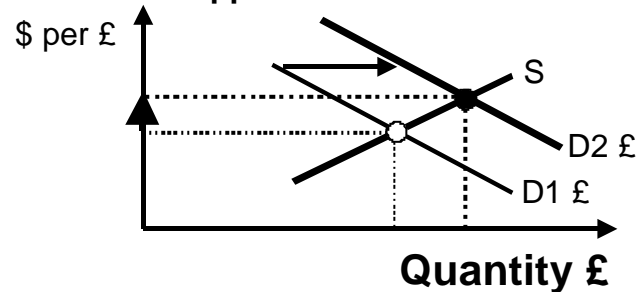
Exchange rate at a **certain moment**



## 22 Appreciation

If, for example, there are more UK-exports than before, demand in £ (and hence supply in \$) are increased. Thus, the £ is **appreciated**; it has a higher value in comparison with the \$. More \$ are needed to buy 1 £, or to put it differently, more \$ can be exchanged for 1 £.

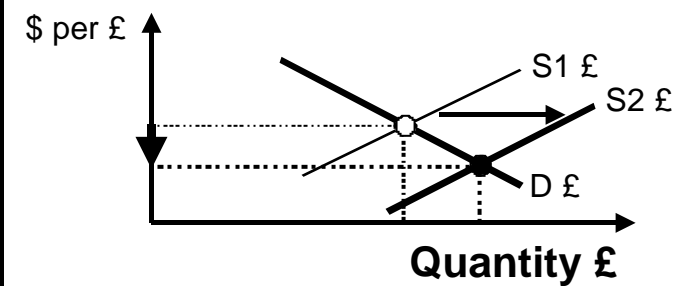
**Appreciation of the £**



## 23 Depreciation

If, for example, interest rates are rising in the US (but not in the UK), more \$ are demanded (and more £ supplied). Therefore, the £ is **depreciated**, it has a lower value in comparison with the \$. Money capital will leave the UK to look for better returns in the US. Less \$ are needed to buy 1 £, or to put it differently, less \$ can be exchanged for 1 £.

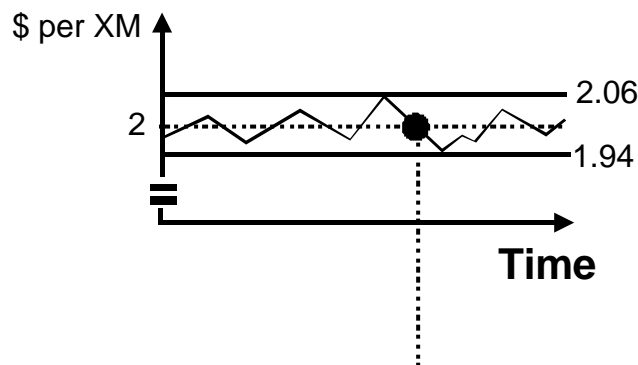
**Depreciation of the £**



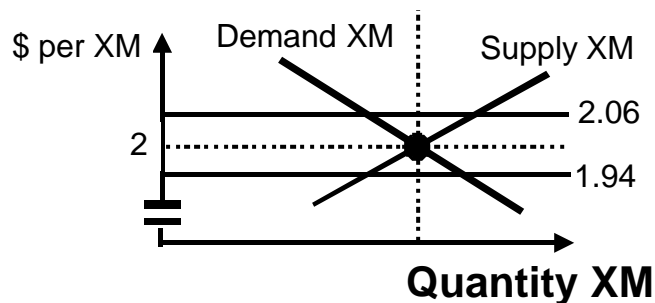
3 There are different possibilities of **fixed exchange rates**, ranging from a monetary union to managed exchange rates. We assume a country X with the currency XM (X-Money). The country X has introduced a fixed exchange rate against the \$ (\$ 1 = 0.5 XM) with narrow margins of 3 % on either side.

**31 Fixed exchange rate**

Fluctuations during a **time period**.

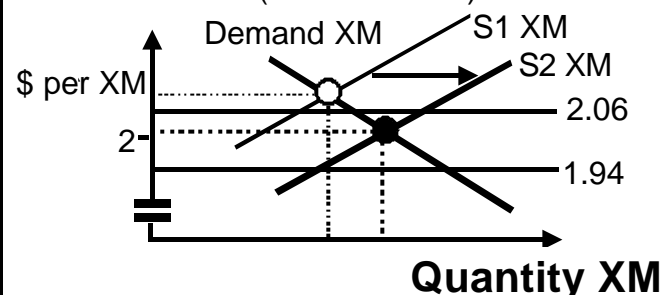


Exchange rate at a **certain moment**

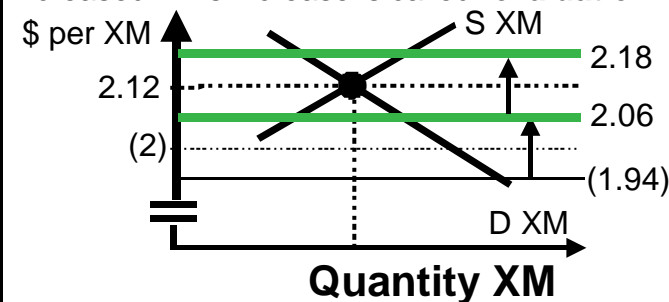


**32 Revaluation**

If the XM is appreciated, the Government should supply XM (and demand \$) to move the exchange rate back to the range between 2.06 and 1.94. The same effect could be obtained if interest rates in X (but not abroad) would fall.

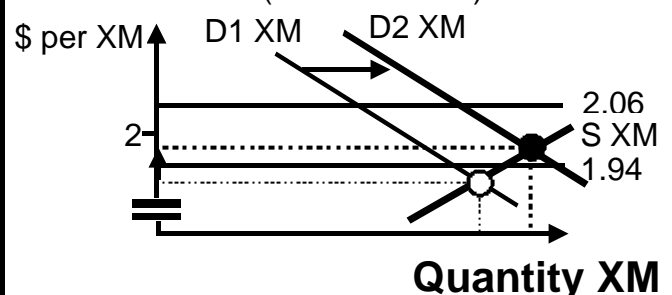


If, however, there is a **chronic appreciation**, the exchange rate and the margins should be increased. This increase is called **revaluation**.



**33 Devaluation**

If the XM is depreciated, the Government should demand XM (and supply \$) to move the exchange rate back to the range between 2.06 and 1.94. The same effect could be obtained if interest rates in X (but not abroad) would rise.



If, however, there is a **chronic depreciation**, the exchange rate and the margins should be lowered. This decrease is called **devaluation**.

