IGCSE ECONOMICS · 2.2 THE GLOBAL ECONOMY · CHAPTER 41 · PAPER 2

Exchange Rates and Their Determination

Topic question sheet L41 | **Total: 27 marks** | **Time: 30 minutes** | **Student Book pp. 333–339**

Instructions: answer **all** questions. Write your answers on lined paper. The marks for each question are shown in brackets: use them as a guide to how much to write.

Calculators may be used. Show your working. Draw diagrams in pencil and label them fully. The mark scheme starts on a new page: do not look at it until you have finished.

Section A: Multiple choice

One mark each. Choose **one** answer: A, B, C or D.

1 Which of the following would affect the demand for a currency? **(1)**

A Levels of unemployment
B The price of imports
C The demand for imports
D The demand for exports

2 If speculators believe the price of a currency is going to fall, they will: **(1)**

A buy that currency
B sell that currency
C stabilise it
D have no effect

3 If £1 = €1.10, a French firm buying £400 000 of UK goods pays: **(1)**

A €363 636
B €400 000
C €440 000
D €4 400 000

4 An increase in the supply of a currency on the foreign exchange market will: **(1)**

A raise its exchange rate
B lower its exchange rate
C raise demand for it
D have no effect

Section B: Short answers

Define, state, calculate, draw and explain. Show your working for calculations.

5 Define an **exchange rate**. **(1)**

6 Calculate the price in US dollars of the tea at the January exchange rate. You are advised to show your working. **(2)**

7 Calculate the cost in K$ of the phones at the January exchange rate. You are advised to show your working. **(2)**

8 Draw a diagram to show the effect of the higher interest rate on the market for Kalari dollars. **(3)**

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Section C: Data response

Read the extract, then answer the questions. Use evidence from the extract in every answer.

Extract: The Kalari Dollar

On 1 January, the fictional Kalari dollar (K$) was worth US$0.80. A Kalari tea exporter sold K$500 000 of tea to a US buyer, and a Kalari retailer bought US$120 000 of phones from a US supplier.

During the year, Kalari's central bank raised interest rates from 3% to 6%, and speculators began buying K$. By December, K$1 = US$0.95.

Fictional case, written for this sheet.

9 With reference to the extract, analyse why the Kalari dollar rose in value during the year. **(6)**

10 With reference to the extract, assess whether interest rates or speculators were more important in causing the rise in the Kalari dollar. **(9)**

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Mark scheme: Exchange Rates and Their Determination

How to mark: Multiple choice, Define, State: 1 mark. **What is meant by** (2): two separate parts to the definition. **Calculate**: working and answer (with units). **Draw** (3): one mark per correct labelled feature. **Explain** (3): 1 for a point, 2 for developing it in context. **Analyse** (6): knowledge 2, application 2, analysis 2. **Assess** (9) and **Evaluate** (12) are marked by levels: choose the level that best fits the whole answer. Indicative content is a guide: credit other valid points.

Section A

1 *Which of the following would affect the demand for a currency? (1 mark)*

Answer: D (The demand for exports). Foreign buyers need the currency.

2 *If speculators believe the price of a currency is going to fall, they will: (1 mark)*

Answer: B (sell that currency). Supply rises, price falls.

3 *If £1 = €1.10, a French firm buying £400 000 of UK goods pays: (1 mark)*

Answer: C (€440 000). 400 000 × 1.10.

4 *An increase in the supply of a currency on the foreign exchange market will: (1 mark)*

Answer: B (lower its exchange rate). Supply shifts right.

Section B

5 *Define an exchange rate. (1 mark)*

The price of one currency in terms of another (1).

6 *Calculate the price in US dollars of the tea at the January exchange rate. You are advised to show your working. (2 marks)*

Working: 500 000 × 0.80 (1).

Answer: US$400 000 (1).

7 *Calculate the cost in K$ of the phones at the January exchange rate. You are advised to show your working. (2 marks)*

Working: 120 000 ÷ 0.80 (1).

Answer: K$150 000 (1).

8 *Draw a diagram to show the effect of the higher interest rate on the market for Kalari dollars. (3 marks)*

Axes: price of K$ (in US$) and quantity of K$ (1); demand shifts right D1 → D2 (1); exchange rate rises ER1 → ER2 (1).

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Section C

9 *With reference to the extract, analyse why the Kalari dollar rose in value during the year. (6 marks · K2 · Ap2 · An2)*

Knowledge (2): higher interest rates and speculation raise demand for a currency.

Application (2): rates 3% → 6%; speculators buying; K$ up from US$0.80 to US$0.95.

Analysis (2): foreign savers buy K$ to deposit in Kalari banks; speculators' buying adds to demand; demand shifts right, so the exchange rate rises.

Knowledge 2 · Application 2 · Analysis 2.

10 *With reference to the extract, assess whether interest rates or speculators were more important in causing the rise in the Kalari dollar. (9 marks · levels)*

Interest rates: doubling the rate is a strong incentive for hot money; a fundamental cause.

Speculators: may have reacted to the rate rise, amplifying it; can move huge sums quickly.

Judgement: interest rates probably the underlying cause, speculators magnified it; depends on whether speculation continues after rates stop rising.

Levels: L1 1–3 (points listed, little use of the data) · L2 4–6 (developed points, some use of the data, limited evaluation) · L3 7–9 (developed points on both sides using the data, with a supported judgement).

Original practice questions written in the style of the Pearson Edexcel International GCSE Economics (4EC1) papers. This is not an official paper. Unless a source is given, the firms, countries and figures are fictional and made up for practice.

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