

Exchange Rates

People, firms and nations exchange products for money and use the money to buy other products or to pay for the use of resources. Within an economy, prices are stated in the domestic currency, such as U.S. dollars or European euros. Buyers use their currency to purchase goods. International markets are different. Producers in other countries who export goods want to be paid in their own currencies so they can carry out transactions. As a result, a *foreign exchange market* develops where national currencies can be exchanged. Such markets serve the need of all international buyers and sellers. The equilibrium prices in these markets are called *exchange rates*. An exchange rate is the rate at which the currency of one nation is exchanged for the currency of another.

Figure 53.1 shows the exchange rates for selected countries for May and August of the same year.



Figure 53.1
Exchange Rates

	Cost of Foreign Currency in U.S. Dollars (U.S. dollars / foreign currency)		Cost of U.S. Dollar in Foreign Currency (foreign currency / U.S. dollars)	
	May	Aug.	May	Aug.
British pound	1.4	1.8	0.71	0.56
Canadian dollar	0.64	0.63	1.5625	1.5873
European euro	0.87	0.91	1.149	1.099
Swedish krona	0.094	0.093	10.638	10.753
Japanese yen	0.0083	0.0090	120.482	111.111
Mexican peso	0.1101	0.1502	9.083	6.658

Part A

Using the data in Figure 53.1, calculate the cost of the following products in U.S. dollars. To solve, divide the cost of the product in the foreign currency by the cost of the U.S. dollar in the foreign currency.

	May	Aug.
1. A dinner for two that costs 500 Mexican pesos		
2. A hotel room that costs 30,000 Japanese yen		
3. A BMW that costs 85,000 euros in Germany		
4. A pound of Swedish meatballs that costs 30 krona		
5. A pair of pants that costs 72 pounds in London		
6. A leather jacket that costs 1,800 Canadian dollars		

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7. Using the exchange table in Figure 53.1, calculate how much foreign tourists would have to pay in their own currency for an American meal that costs \$60.00. To solve, divide the cost in U.S. dollars by the cost of the foreign currency in U.S. dollars.

	May	Aug.
British pound		
Canadian dollar		
European euro		
Swedish krona		
Japanese yen		
Mexican peso		

8. Did the value of the dollar appreciate (strengthen) or depreciate (weaken) against the following currencies between May and August? (Put an X in the appropriate column.)

	Appreciate	Depreciate
British pound		
Canadian dollar		
European euro		
Swedish krona		
Japanese yen		
Mexican peso		

Part B

When Americans buy more foreign goods, U.S. dollars are sold in the international currency market to purchase foreign currencies that are used to pay producers in their own domestic currencies. Supply and demand graphs are used to demonstrate such transactions. If the demand for a currency increases, the currency appreciates (strengthens) in value. Currencies sold to purchase other monies depreciate (weaken) in value.

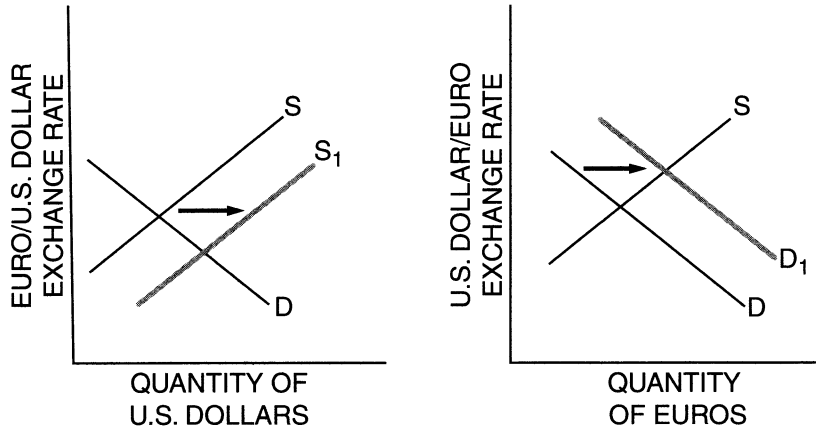
Consider the following situations. In each case, an underlying event causes a change in the supply and demand for currencies. Indicate the impact of each scenario on each currency. The first example is done for you as a model.

9. The prices of U.S. goods rise relative to the prices of German goods.



Figure 53.2

Prices of U.S. Goods Increase



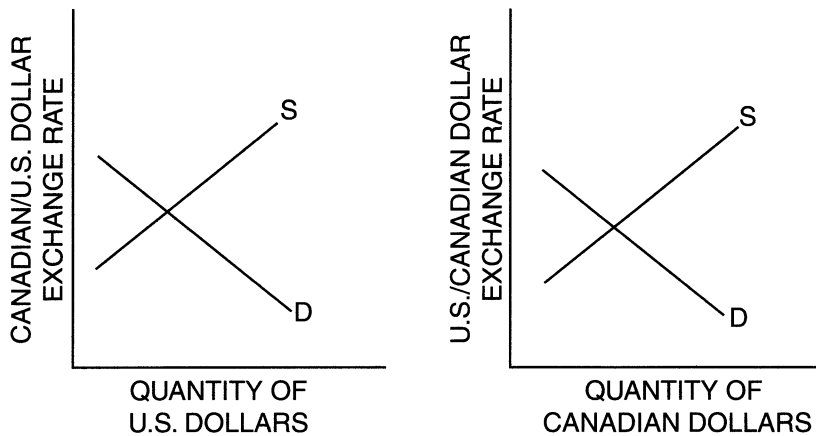
Rationale: Americans will demand less expensive German goods, thereby increasing the demand for euros and supplying more dollars to the foreign exchange market. The U.S. dollar depreciates. The euro appreciates.

10. Interest rates in the United States rise faster than interest rates in Canada.



Figure 53.3

Interest Rates in the United States Increase



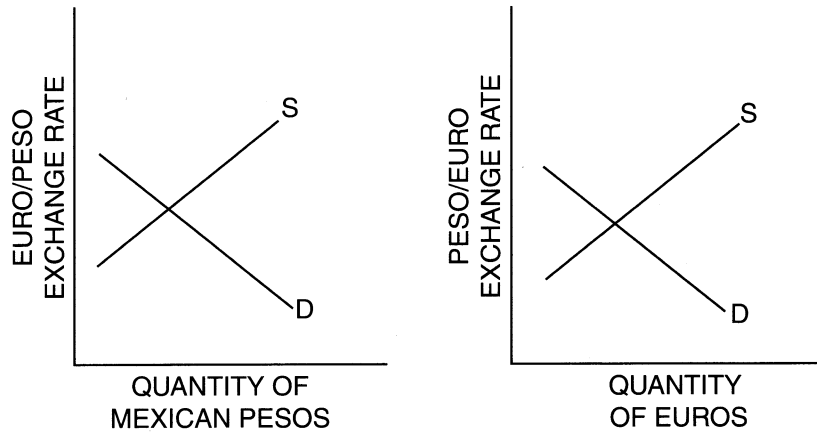
Rationale:

11. French tourists flock to Mexico's beaches.



Figure 53.4

French Tourists Visit Mexico



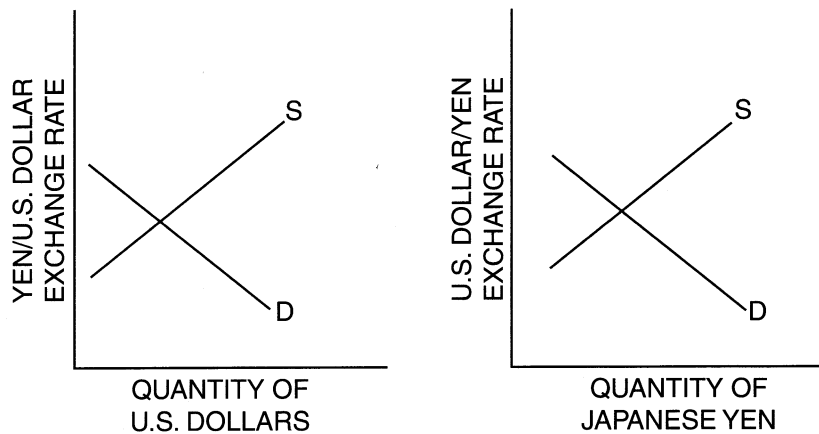
Rationale:

12. Japanese video games become popular with U.S. children.



Figure 53.5

U.S. Children Want Videos Produced in Japan



Rationale: