2002 HIGHER SCHOOL CERTIFICATE EXAMINATION

Economics

Section II

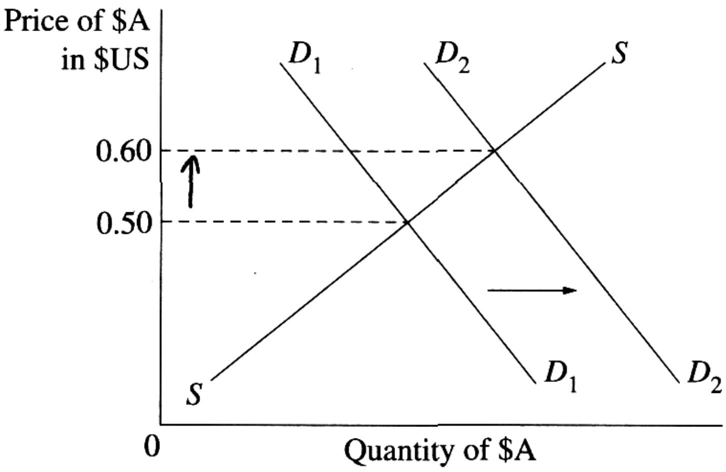
40 marks
Attempt Questions 21–24
Allow about 1 hour and 15 minutes for this section

Answer the questions in the spaces provided.

Marks

Question 21 (10 marks)

The diagram shows information about the demand and supply of Australian dollars ($A) in terms of United States dollars ($US). Both countries have flexible exchange rates.



(a) State the economic term given to the movement of the exchange rate of the $A from $US0.50 to $US0.60. **1**

'Appreciation'

(b) Outline TWO causes of an increase in demand for $A. **2**

- Increased demand for Australian exports
- Increased ~~interest~~ domestic rates ~~make~~ attracts ~~in~~ foreign investment

Question 21 continues on page 10

Marks

Question 21 (continued)

(c) Briefly explain how the Reserve Bank could intervene in the foreign exchange market to influence the exchange rate of the $A. **3**

They can 'dirty the float' by directly intervening in the exchange market by buying or selling $A. If RBA buys $A leads to rapid depreciation. If RBA sell $A leads to rapid appreciation. Also the RBA can influence exchange rate of $A with monetary policy such as reducing interest rates or increasing interest rates to influence demand of $A.

(d) Discuss TWO economic benefits to Australia of an appreciation of the $A. **4**

~~Australi~~ The value of Australian's foreign external debt and the interest required to service this debt will fall in terms of $A, as $A can buy more foreign currencies to repay interest. Also ~~there ar~~ with a appreciation of the $A this will lead to a fall in inflationary pressures, as imports are cheaper to buy.

End of Question 21