Lesson 12: International Exchange

Reading: Chapter 18

In this lesson we will:
- Analyze how currency exchange are determined through the exchange market
- Discuss how currency crises occur

Every time a company, a consumer or an investor purchases a product or an asset from a foreign country that does not use the same currency he must exchange currencies in the foreign exchange market first. This market is composed of financial institutions.

- Currencies are exchange at the exchange rate, which denotes the amount of the foreign currency that an individual can get for a given unit of the local currency.
- When the local currency appreciates its value goes up and the individual will be able to obtain more foreign currency for it; when it depreciates it decreases in value.
- Exchange rates are either flexible, which means that their rate can freely fluctuate, or fixed to another currency or a basket or currencies. Can you think of any examples?

Exchange rates are determined in the foreign exchange market via the supply and demand for the currency.
- Anything that will increase demand for the country’s exports will increase the demand for the country’s currency. Like what?
- Anything that will increase the demand for imports in the country will increase the supply of the currency. Explain why and give examples.
- Anything that will increase the demand for the country assets will increase the demand for the currency. Give examples.
- Speculations that the country’s currency will appreciate will increase the demand for the currency (why and how will that effect the value of the currency?)
- Speculations that the currency will depreciate will decrease the currency’s demand
- A higher rate of inflation will cause the currency to depreciate

![Graph showing supply and demand for foreign exchange](image)

Quantity of Foreign Exchange (in dollars)

Review: pp. 442-3, Problems 4, 5, 8, 9 & 15