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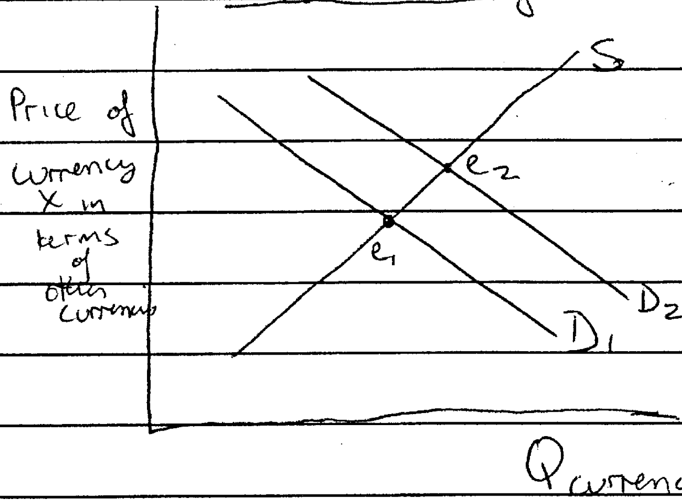
3MACCLA1

Write in the box the number of the question you are answering on this page as it is designated in the examination.

a) Foreign-exchange Market for X's Currency



The impact of the capital inflow into country X would cause the currency to appreciate. This is because to place capital in country X, the person must have X's currency. Thus, he will try to buy that currency, causing the demand for the currency to increase (from D_1 to D_2). This results in a new equilibrium in the foreign-exchange market at e_2, at which point the international value of X's country is higher than it was at the original equilibrium e_1.

b) i) The increase in the value of X's currency would cause a decrease in the country's exports. This is because to buy goods from the country, foreigner's would first have to buy the currency. Since the currency has become

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3MAECLA2

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b) relatively more expensive, this would discourage foreigners from buying it and thus buying X's ~~the~~ goods, hence reducing X's exports.

ii) Similarly, ~~the~~ X's imports would increase because to buy imported goods, X's citizens would need to buy foreign currencies. Since these currencies are now cheaper relative to X's currencies, the goods themselves appear cheaper, as each unit of X's currency can buy more imported goods. This provides the incentive for X's consumers to buy more imported goods, therefore increasing imports.

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