

A background illustration of Spider-Man in his iconic red and blue suit, crouching in a dense network of grey spider webs. The scene is set against a warm, orange-toned background of a city building facade. The text 'Foreign Exchange Market' is written in a large, bold, blue, blocky font, with a horizontal blue line underneath. Below the line, the word 'FOREX' is written in a smaller, blue, serif font.

Foreign Exchange
Market

FOREX

Foreign Exchange (FOREX)

- The buying and selling of currency
 - Ex: In order to purchase souvenirs in Kenya, it is first necessary for Americans to sell their Dollars and buy Shillings
- Any transaction that occurs in the Balance of Payments (will get to that in detail later) necessitates foreign exchange
- The exchange rate (e) is determined in the foreign currency market
 - Ex: The current e is approximately 87.4 Shillings to 1 Dollar
- Simply put – e is the price of a currency

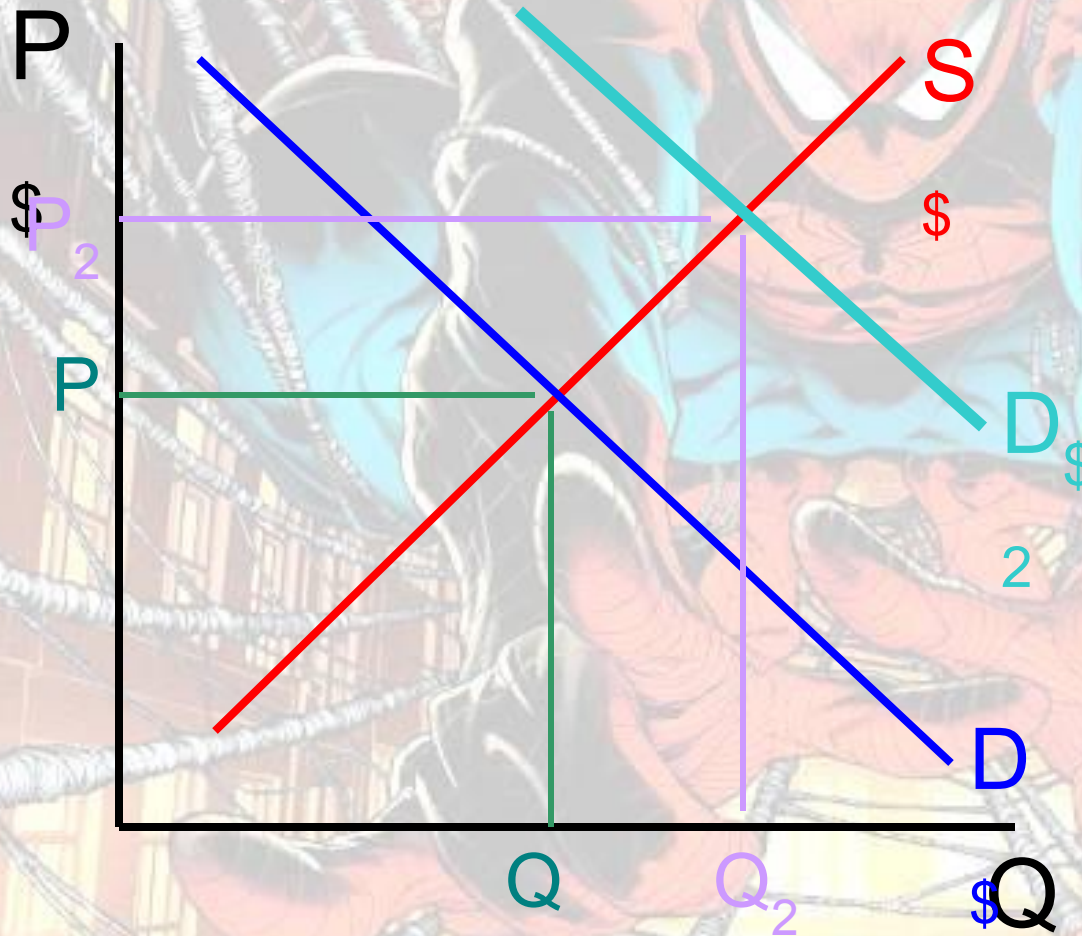
Changes in Exchange Rates

- Exchange rates are a function of the supply and demand for currency
 - An increase in the supply of a currency will decrease the exchange rate of a currency
 - A decrease in supply of a currency will increase the exchange rate of a currency
 - An increase in the demand for a currency will increase the exchange rate of a currency
 - A decrease in demand for a currency will decrease the exchange rate of a currency

Appreciation & Depreciation

- Appreciation of a currency occurs when the exchange rate of that currency increases ($e \uparrow$)
- Depreciation of a currency occurs when the exchange rate of that currency decreases ($e \downarrow$)
 - Ex: If Kenyan tourist flock to America to go shopping, then the supply of shillings will increase and the demand for dollars will increase. This will cause the shilling to depreciate and the dollar to appreciate.

FOREX Market



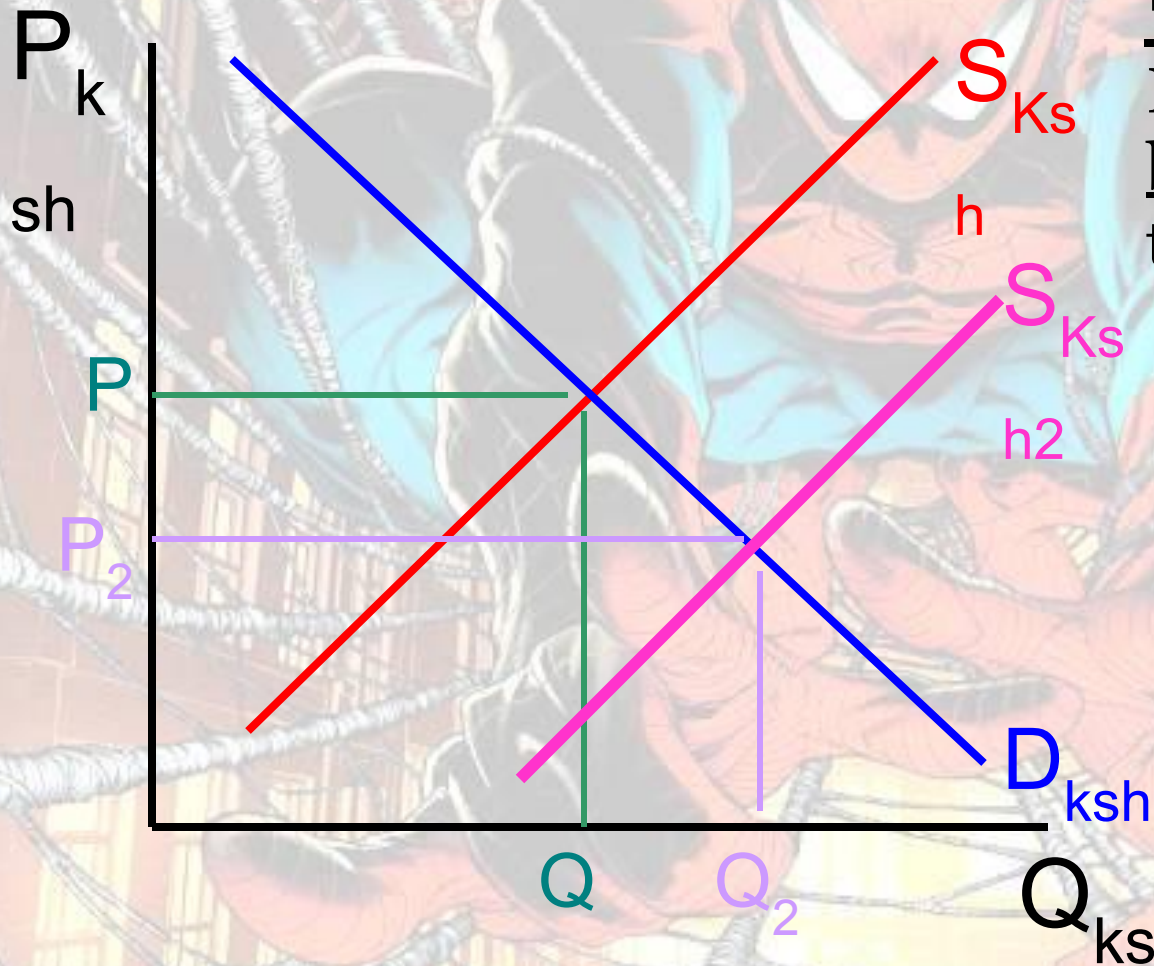
Dollar Market

How many dollars it takes to buy a (fill in blank currency)

$D_{\$} \uparrow \therefore P_{\$} \uparrow \& Q_{\$} \uparrow$

This means each \$ would “buy” more of (fill in the blank currency)

FOREX Market



Foreign Market

How many (fill in blank currency) it takes to buy a dollars

$$S_{KSh} \uparrow \therefore P_{KSh} \downarrow \text{ \& } Q_{KSh} \uparrow$$

This means each Shilling would “buy” less \$s

Exchange Rate Determinants

- Consumer Tastes
 - Ex: A preference for Japanese goods creates an increase in the supply of \$s in the currency exchange market which leads to depreciation of the \$ and an appreciation of the Yen (¥)
- Relative Income
 - Ex: If France's economy is strong and the U.S. economy is in recession, then the French will buy more American goods, increasing the demand for the \$, causing the \$ to appreciate and the Euro (€) to depreciate

Exchange Rate Determinants

- Relative Price Level
 - Ex: If the price level is higher in Britain than in the United States, the American goods are relatively cheaper than British goods, thus British will import more American goods causing the \$ to appreciate and the Pound (£) to depreciate
- Speculation
 - Ex: If U.S. investors expect that Swiss interest rates will climb in the future, then American will demand Swiss Francs (F) in order to earn higher rates of return in Switzerland. This will cause the \$ to depreciate and the Swiss Franc to appreciate.

Exports and Imports

- The exchange rate is a determinant of both exports and imports
- Appreciation of the \$ causes American goods to be relatively more expensive and foreign goods to be relatively cheaper thus reducing exports and increasing imports
- Depreciation of the dollar causes American goods to be relatively cheaper and foreign goods to be relatively more expensive thus increasing exports and reducing imports

Now lets connect all this
together ...



it's so easy, I promise ...