2.21 Exchange Rate Systems and the Determination of Floating Rates: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. The diagram question and the final 25-mark essay should be answered in full sentences. No calculator is allowed. Time guidance: 10 minutes.

1 Foreign exchange market diagram task, context UK spot market for sterling (£) against the euro (EUR). Draw a supply and demand diagram for GBP priced in EUR with exchange rate on the vertical axis and quantity of GBP on the horizontal axis. The Bank of England unexpectedly raises UK interest rates above those in the euro area. Show and label the initial equilibrium and the effect of the interest rate rise. Identify the new equilibrium exchange rate direction and the correct shift. Explain your diagram in one sentence.



(Total for Question 1 is 4 marks)

2 State one advantage for UK exporters of a fixed exchange rate system. Explain briefly why this advantage may matter for trade decisions.

(Total for Question 2 is 2 marks)

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3 Define a fixed exchange rate system for a national currency such as sterling (£).

(Total for Question 3 is 1 mark)

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Mark scheme · 2.21 Exchange Rate Systems and the Determination of Floating Rates: 10-minute Pack

Question 1

labels axes correctly: exchange rate (EUR per GBP) vertical, quantity of GBP horizontal	**B1**
shows initial equilibrium point E1 where D1 and S1 intersect	**B1**
correctly shifts demand for GBP to the right (D1 to D2) to reflect higher UK interest rates attracting capital	**B1**
shows new equilibrium E2 with a higher exchange rate (EUR per GBP) indicating sterling appreciates	**B1**

Answer: Diagram shows D shift right to D2, new equilibrium E2 at a higher EUR/GBP rate; sterling appreciates.

Question 2

states an advantage, e.g. greater exchange rate stability/predictability for exporters' revenues and pricing	**B1**
explains why: reduces exchange rate risk so firms can plan prices, contracts and investment with less hedging cost	**B1**

Answer: Fixed rates give exporters exchange rate stability, reducing uncertainty about future revenues and lowering the need for costly hedging when setting export prices and contracts.

Question 3

a system where the monetary authority pegs the currency to another currency or basket and intervenes to keep the exchange rate at the chosen parity	**B1**

Answer: A system where the monetary authority pegs the currency to another currency or basket and intervenes to maintain that parity.

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