The Impact of Exchange Rates Answers

Name: ______________________________ **Date:** ______________

Directions: Using correct terminology, write one or two sentences describing what is most likely to happen in each of the following situations. Be prepared to discuss your answers with the class.

A. Assume the United States dollar is appreciating in value. Explain the effect of this strong dollar on each of the following; also explain why that effect would occur.

1. The price of Pakistani rugs.
The price appears to fall, because the dollar can buy even more Pakistani currency.

2. The number of rugs imported from Pakistan.
More rugs are imported, because the price of each rug appears to be lower.

3. US demand for the Pakistani currency of Rupees.
The demand for Pakistani currency rises, because we must buy Pakistani currency to buy Pakistani products.

4. Profits of importers, such as Pier One Imports.
Profits can increase, if the firms incur lower costs for the merchandise, but sell the product to customers at the same price as before the lower costs were incurred.

5. The price of US machinery, to Pakistani retail firms.
The price will appear to increase, because a stronger dollar makes Pakistani currency relatively weaker.

6. The amount of US machinery exported to Pakistan.
Exports will decrease, because the higher price reduces the quantity demanded.

7. Pakistani demand for US Dollars.
The demand for US dollars falls, because if demand for exports falls, there is less need for dollars to pay for those exports.

8. The profits of exporters, such as US machinery producers.
Profit can fall, if the demand for an exported product falls and the firm must lower prices.

9. United States balance of trade (trade deficit or trade surplus?)
As imports increase and exports decrease, a trade deficit develops.

B. Assume that the United States dollar has depreciated in value. Explain the effects of this weak dollar on each of the following and why that effect would occur.

1. US imports of foreign products.
Imports will fall, because the prices of imports appear to have risen.

2. US exports to foreign consumers.
Exports will rise, because the price of exports appears to have fallen, to foreign consumers.

3. United States balance of trade (trade deficit or trade surplus?)
As imports decrease and exports increase, a trade surplus develops.

C. Explain whether each of these people would prefer a strong or a weak dollar, and why.

1. A corn farmer in the Midwest.
Farmers prefer a weak dollar, because it makes their crops appear less expensive to foreign consumers, increasing their demand for the farmer's export.

2. A line worker at an auto plant.
Auto plant line workers prefer a weak dollar, because it makes their cars appear less expensive to foreign consumers, increasing their demand for the automaker's export. In addition, a weak dollar makes imported cars appear more expensive, reducing US demand for foreign competitors' cars.

3. A gas station owner.
Gas station owners prefer a strong dollar, because it makes their imported gas appear less expensive.

4. A banana consumer.
Banana consumers prefer a strong dollar, because it makes their imported bananas appear less expensive.