AP Dojo

AP Macroeconomics
Unit 6 - Cheat Sheet

Unit 6 - Open Economy - International Trade & Finance

Enduring Understanding	Topic	Suggested Skills
MEA-4	6.1 Balance of Payments Accounts	1.A Describe economic concepts, principles, or models.
MKT-5	6.2 Exchange Rates	1.C Identify an economic concept, principle, or model using quantitative data or calculations.
	6.3 The Foreign Exchange Market	4.A Draw an accurately labeled graph or visual to represent an economic model or market.
	6.4 Effect of Changes in Policies and Economic Conditions on the Foreign Exchange Market	4.C Demonstrate the effect of a change in an economic situation on an accurately labeled graph or visual.
	6.5 Changes in the Foreign Exchange Market and Net Exports	3.A Determine the outcome of an economic situation using economic concepts, principles, or models.
	6.6 Real Interest Rates and International Capital Flows	3.B Determine the effect(s) of one or more changes on other economic markets.

<u>6.1 - Balance of Payments Accounts</u>

<u>Balance of Payments Accounts</u> - measure all *international transactions* in a year

- Two accounts: current account and financial account

<u>Current Account</u>: the sum of net exports, net income from abroad, and net unilateral transfers

- <u>Net income from abroad:</u> the difference between the income earned by foreigners in a country and the income earned by citizens of that country in foreign countries
- <u>Net unilateral transfers:</u> payments from one country to another that do not correspond to the purchase of any good, service, or

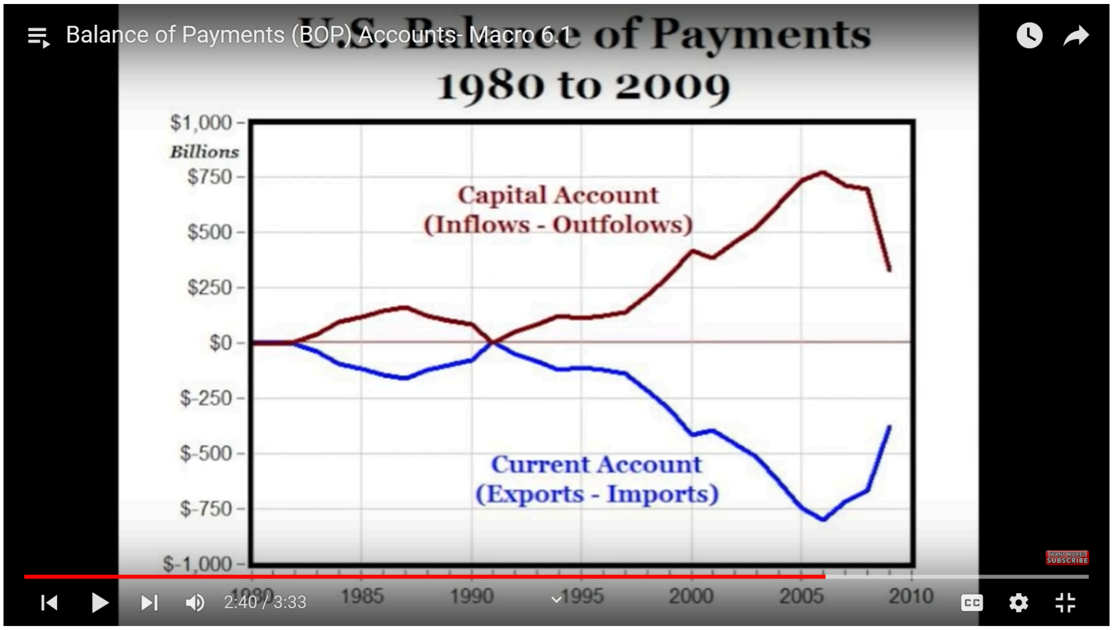
asset (money given to another country, with nothing expected in return)

- Exports > Imports = trade surplus
- Exports < Imports = trade deficit
- Trade Deficit (Example): US imports from China are higher than their exports to China
- Trade Surplus (Example): Chinese exports to the US are higher than their imports from the US

Financial (Capital) Account: measures the ownerships of assets held by foreigners and the ownership of foreign assets (EXAMPLES OF FINANCIAL ASSETS: stocks, bonds, real estate, etc.)

- Inflow of Assets (Example): Chinese investors invest more money in the US stock market (inflow for the US)
- Outflow of Assets: US Banks purchase Chinese government bonds (outflow for the US)

** If the US has a **current account deficit** with China, it will have an **inflow of capital** from China (China uses their money from trade to buy US assets)



<u>6.2 - Exchange Rates</u>

<u>Exchange Rate:</u> the price at which one international currency can be exchanged for another.

The trick is to remember that you supply your currency and the people in other countries demand your currency

<u>Currency Appreciation</u>: an increase in the value of one currency in relation to another currency
2022: 100 yen / 1 usd
2024: 150 yen / 1 usd

- In this example the USD appreciated

<u>Currency Depreciation</u>: a decrease in the value of one currency in relation to another currency
2022: 100 yen / 1 usd

2024: 150 yen / 1 usd

- In this example the Yen depreciated

6.3 - The Foreign Exchange Market

Foreign Exchange Market: the interaction of buyers and seller exchanging the currency of one country for the currency of another

- The interaction between buyers and seller determines the exchange rate
- The exchange rate influences the flow of goods, services, and financial capital between countries

Why Do People Demand Foreign Currency?

1) To purchase goods or services from that country
2) To purchase financial assets from that country (like bonds)

Graphing Exchange Rates

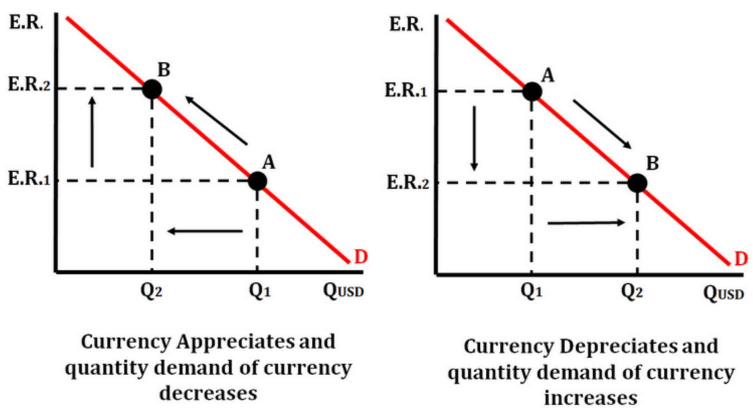
Important:

- Foreigners who want US dollars make up the demand for US dollars
- US citizens make up the supply of US dollars
- When comparing two currencies, if one appreciates the other will depreciate

Foreign Exchange Demand: the quantity of an international currency that all domestic and foreign currencies are willing and able to purchase at various rates of exchange

The relationship between the exchange rate and the quantity demanded of a currency is inverse

- As the exchange rate rises, domestic and foreign consumers will purchase less quantity of the currency
- As the exchange rate falls, domestic and foreign consumers will purchase a greater quantity of the currency.



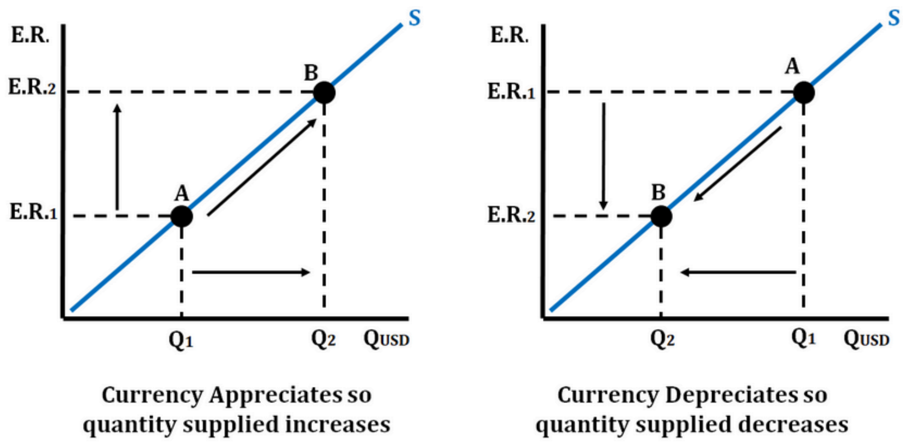
Europeans can demand the US dollar for two reasons:

1) To buy US goods and services
2) To invest in the US

<u>Foreign Exchange Supply</u>: the quantity of an international currency that all domestic and foreign sellers are willing and able to sell at various rates of exchange

The relationship between exchange rates and quantity of currency supplied is positive or direct

- As exchange rates rise, domestic and foreign consumers are willing to sell more
- As exchange rates fall, domestic and foreign consumers are willing to sell less



US citizens can demand the Euro for two reasons:

1) To buy European goods or services
2) To invest in European countries

<u>4 Shifters of Supply and Demand:</u>

1) Tastes and Preferences
2) Income
3) Price Level
4) Interest Rates

- What happens to demand for USD?
- Does the USD appreciate or depreciate?
- What curve shifts (and which way) on each graph?

<u>Example of Foreign Exchange Market Graph:</u>