UNIT 6 AP MACROECONOMICS

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UNIT 6: Open Economy- International Trade and Finance

BALANCE OF PAYMENTS:

The balance of payments is the **difference** between all **<u>international purchases and sales in a period of time.</u>** Balance of payments can be **classified** into the **<u>current account and the financial account:</u>**

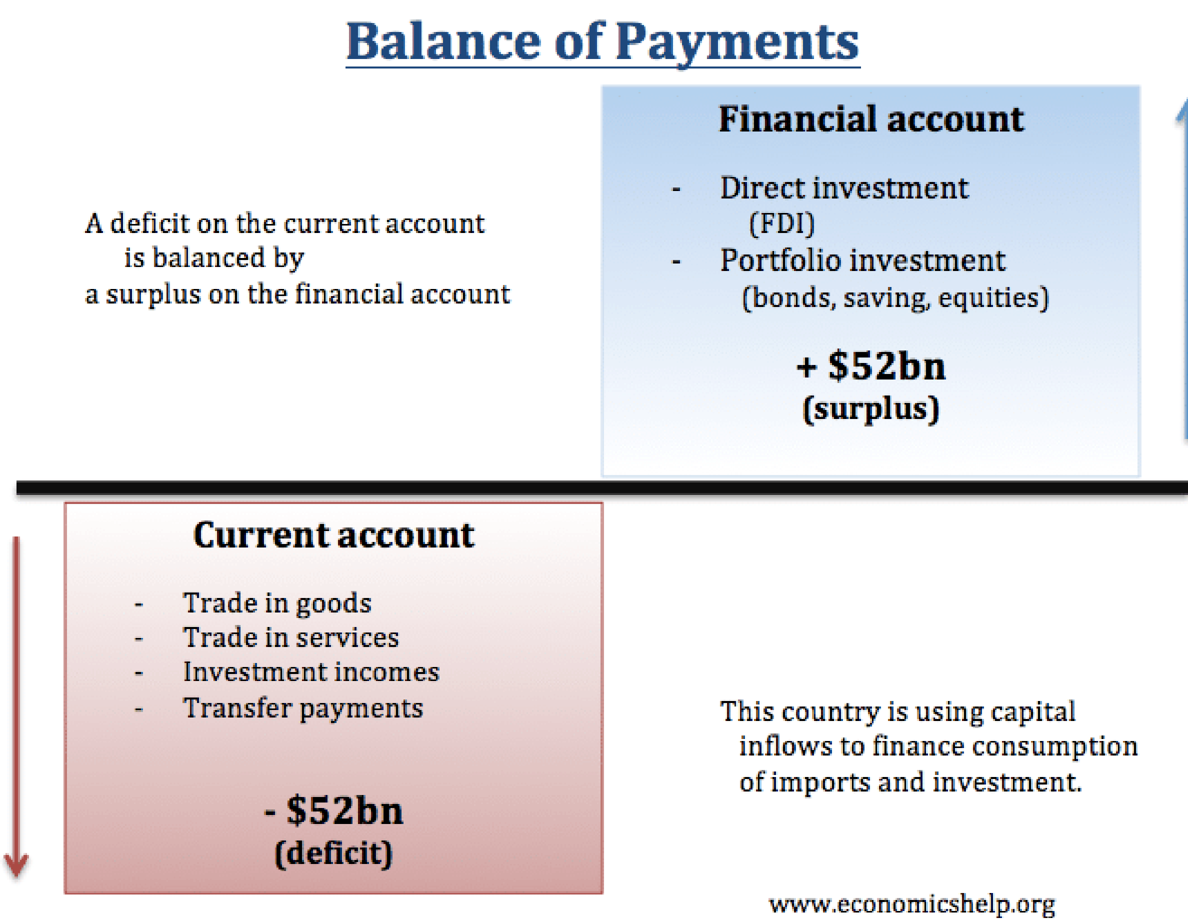

PHOTO: https://www.economicshelp.org/macroeconomics/bop/

TYPES OF ACCOUNTS:

Current Account:

- Net exports/imports of goods (**Balance of Trade**)
- Net exports/imports of services
- ***Net income*** (investment income plus employee compensation)
- ***Net transfers***

Capital Account:

- Purchase and sale of **fixed assets –** example → real estate

Financial Account:

- ***Net foreign direct investment***
- Net portfolio investment

OTHER FINANCIAL ASSETS

Reserves:

- Changes in the official monetary reserves

TRADE DEFICITS AND TRADE SURPLUS:

Trade Deficit:

Imports are greater than exports → BUYING more than SELLING

Trade Surplus:

Exports are greater than imports → SELLING more than BUYING

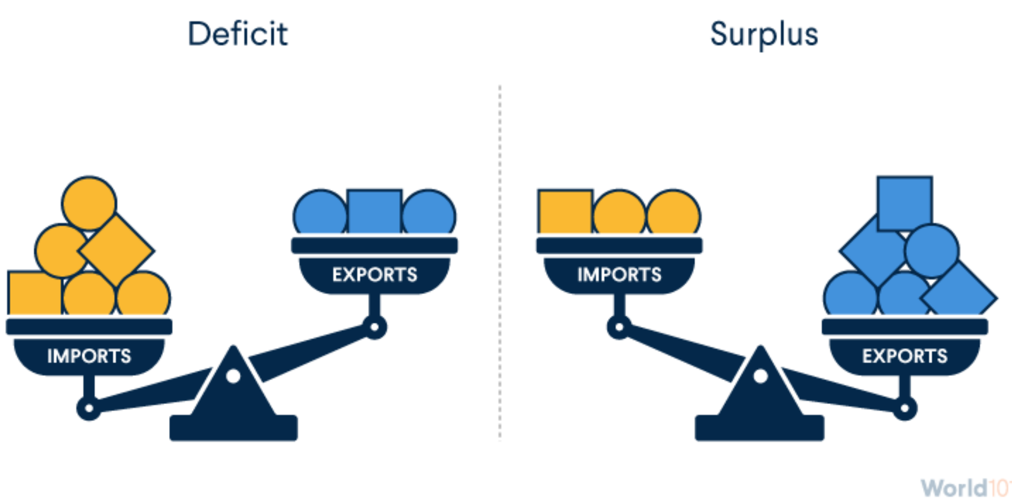

PHOTO: https://world101.cfr.org/global-era-issues/trade/what-trade-deficit-means

EXCHANGE RATES

Appreciation:

- The ***general increase in the price of an asset overtime.***
  - **Example:** in 2018 the price of my house was $200k, in 2020 the price of my house rose to $400k. This would be an appreciation in price.

Depreciation: The ***general decrease in the price of an asset overtime.***

REGARDING CURRENCY:

- **Appreciation:**
  - The value of a nation's currency increases. (This means it is worth MORE compared to other nations.)
- **Depreciation:**
  - The value of a nation's currency decreases. (This means it is worth LESS compared to other nations.)

FOREIGN EXCHANGE MARKET: WHAT IS IT?

- Represents the currency foreign exchange rates for countries

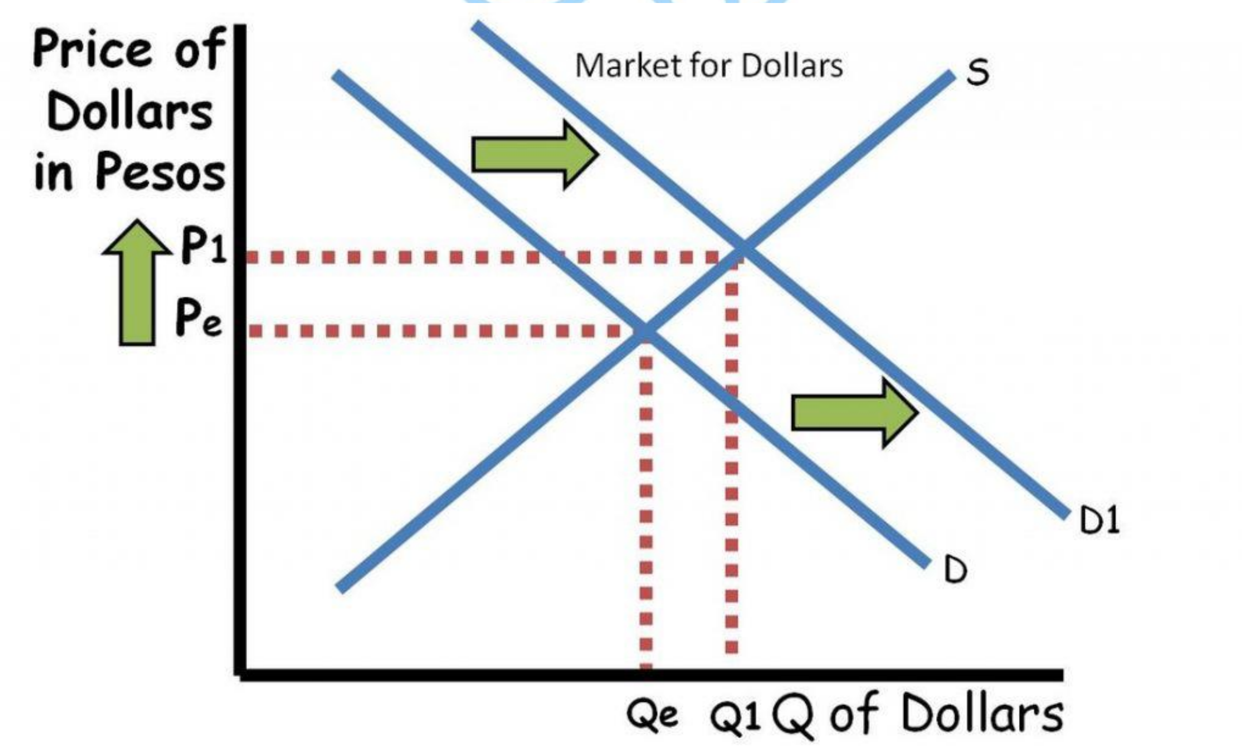

PHOTO: https://www.reviewecon.com/foreign-exchange

Equilibrium Exchange Rate: When countries **trade currency**, there is an **exchange rate**. At the equilibrium, the quantity of **currency demanded** is equal to the quantity of **currency supplied.**

Floating exchange rate: The price of a nation's currency is determined by the **foreign exchange market** (relation to other currencies).

There is a SUPPLY and a DEMAND for the currency:

- In the foreign exchange market, there is a ***BUYER and a SELLER of currency.***
- Countries are **trading currency** and are based on levels of appreciation or depreciation. (They have different values.)
    - For example: The U.S. dollar is worth more than the Canadian dollar. (This would be because the U.S. dollar is stronger in the rate of exchange.)

SHIFTERS OF THE FOREIGN EXCHANGE MARKET

- ***Change in preference***
    - This means a nation will want less of a certain currency.
    - For example: Italy's economy goes into a depression and the currency depreciates
    - This would decrease the demand of the euro when trading currency with Italy.
- ***Change in national inflation***
- ***Change in real interest rates***

REAL INTEREST RATE:

The real interest rate is the interest rate that is **adjusted for inflation** by **subtracting the rate of inflation.**

CALCULATE:

$$\text{Real Interest Rate} = \text{Nominal Interest Rate} - \text{Rate of Inflation}$$

PHOTO: **https://www.intelligenteconomist.com/real-interest-rate/**

- Change in wages and income

- **BOTH ONLY SHIFT WHEN:**
  - ***If there is a change in inflation and income***

In your graph, always label (as displayed above). It's also helpful to know currency symbols of other nations!

CURRENCY MARKET:

PHOTO: https://www.wallstreetmojo.com/currency-market/

Domestic Price:

- The **cost of a good.**
  - When trading, we think of the domestic price vs the price in other nations for the potential of training.

GRAPH EXAMPLE:

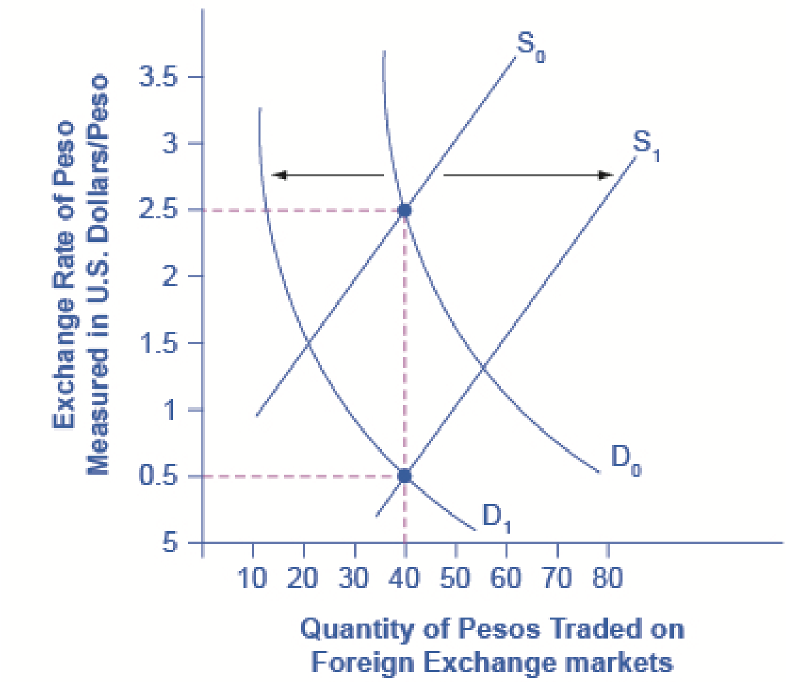

PHOTO: https://courses.lumenlearning.com/macroeconomics/chapter/reading-demand-and-supply-shifts-in-foreign-exchange-markets-2/

- This example compares the quantity of pesos and the exchange rate of pesos.