

Section III — Answer either Question 25 or Question 26

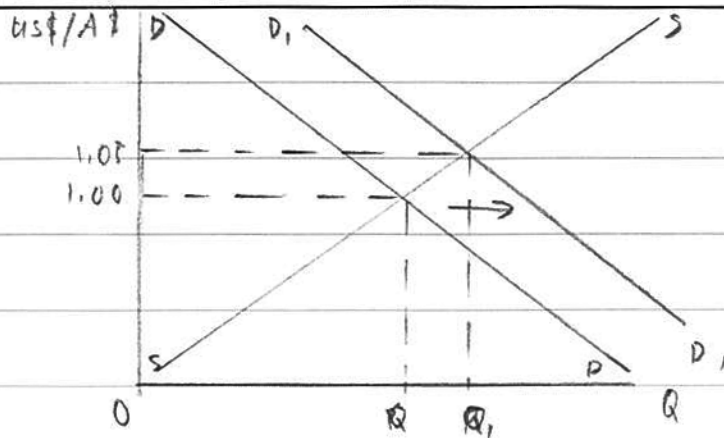
25

Question Number

Write the question number in the space provided

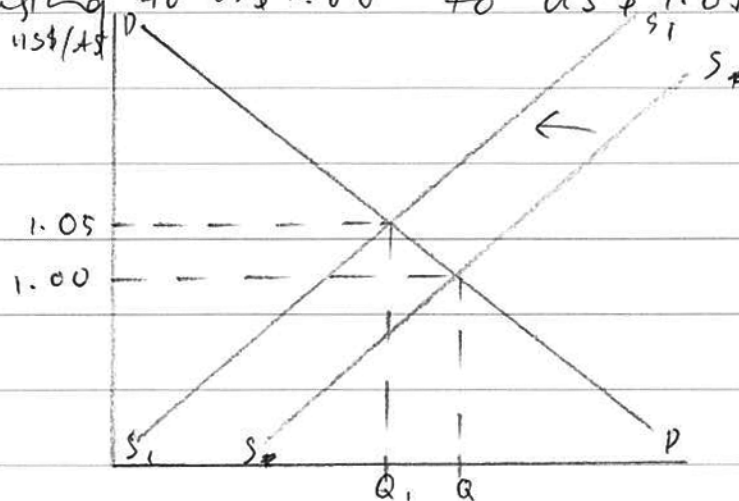
Exchange rates refers to the value at which a unit of currency, in Australia's case, the Australian Dollar (AUD), is exchanged for a given amount of ~~foreign~~ foreign currency e.g. USD. Movements in the AUD occur ~~in~~ on the forms of appreciation and depreciation which are influenced by the demand and supply of the AUD. ~~These movements will effectively influence the economy's performance~~ ~~is~~ and the AUD has fluctuated significantly since it was floated in December 1983, and these movements have had significant impacts on our economy.

A movement in the AUD is an appreciation and it ~~occurs~~ results in a higher international purchasing power due to the increase of the international value of the AUD. ~~This can occur~~ the following diagrams show how ~~a~~ changes in demand and supply can cause an appreciation.



The Effect on the
AUD due to an
increase in Demand.

The diagram shows how an increase in demand from D to D_1 , can lead to the AUD increasing to US\$ 1.00 to US\$ 1.05.



The Effect on the
AUD due to a
Decrease in Supply

The diagram above shows how a decrease in supply of AUD from S to S_1 , can cause the AUD to increase from US\$ 1.00 to US\$ 1.05. Thus it is evident that an appreciation is caused by increases in demand and decrease in supply of AUD.

Since 2001, the AUD has appreciated significantly, reaching US\$ 0.50 by February 2004, (as seen in the STIMULUS) a significant increase

from US \$ 0.48 in April 2001. This was due to our strong economic performance, high commodity rates and America's poor economic performance. As a result, investors ~~invest~~ move their money to our country as we are more attractive investment destinations. ~~Then~~ The AUD appreciated to a high of US\$ 1.10 in 2011 ^{due to the benefits of the resource boom (stimulus)} and as a result, ~~the~~ ^{our} Terms of Trade (TOT) reached a 140 year high of ~~TOT~~ 130.2 and our living standards improved. However, an appreciated dollar erodes the international competitiveness of sectors such as the manufacturing, tourism and education ~~sector~~. This prevents them from maintaining ^{profits and} exports cheaper & imports ^{will make} ~~the~~ ^{dearer,} ~~dearer,~~ Also, an appreciated dollar ^{this} ~~decreases~~ ^{our} price competitiveness, ~~and~~ ^{and} ~~this~~ ^{increases} our net foreign liabilities as ~~we increase~~ exports increase ~~the~~ as they are now cheaper while imports decrease as they are more expensive ~~than~~ ^{as a result of the} ~~increase in the~~ ^{due to} the appreciated dollar. ~~As this~~ ^{As this} increases the size of our CAD, which has a negative effect on our external balance. However, the debt servicing ratio decreases due to the appreciated dollar, which decreases the CAD in the long term through the

valuation effect. Thus ~~depreci~~ in the short-term an appreciation may appear to have a negative effect on our economy but the long-term benefits of higher standard of living and lower CAD has a beneficial effect.

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Another movement in the AUD is the ~~app~~ depreciation, which occurs when there is a decrease in ~~supply~~^{demand} or increase in supply, leading to a decrease in international purchasing power of the AUD.

Despite the continual trend of appreciation ~~in~~ since 2001, the AUD depreciated considerably relative to international currencies from

August 2007 to March 2008 due to the GFC.

The GFC increased economic uncertainty thus decreased aggregate demand in the Aus

economy. The AUD fell from US\$ 0.90 in ~~August~~ March 2007

~~October~~ to US\$ 0.65 in October 2007, (stimulus)

This had a negative effect on our terms of trade, which deteriorated to ~~98~~ 98.

in September. However, a depreciated

dollar encourages capital inflow as our exports are cheaper ^{and imports are dearer}. This increase in exports

and decrease in imports will decrease our

CAD, which reached a low of 50%

of GDP in June 2007. The depreciated

dollar will have a positive effect on Australia's education, tourism and manufacturing sectors as their international competitiveness improves, allowing them to gain more profit. This allows the Australian economy to achieve a greater economic growth. However, a depreciation will lead to a increase in debt servicing costs, leading to a ^{long term} increase in the CAD through the valuation effect. Thus a depreciation can lead to a short-term improvement in Australia's economic performance, but in the long term has a negative effect.

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Thus increases and decreases in the level of demand and supply for the AUD can have both a negative ^{and positive} effect. As seen in the stimulus "there are some winners and some losers". Although depreciation improves our price competitiveness in the short term, it would eventually lead to a large CAD, ~~and~~ through the valuation effect. Thus a gradual appreciation will have a long term ~~increase~~ beneficial effect on the Aus economy in the form of higher standards of living, better terms of trade and smaller CAD.