Chapter 29 Project

Exchange Rates and International Capital Flows

Purpose

In this chapter, you learned the determinants of demand and supply for currencies in foreign exchange markets. You also learned how fluctuations in foreign exchange rates affect various international market participants.

The purpose of this project is to identify the impact of changes in currency markets and research real-world cases of losers due to currency appreciation.

Directions

This project has three parts. In the first, you will apply the concept of currency markets to international trade.

In the second, you will calculate gains or losses from currency exchange and identify changes to currency values due to determinant changes.

In the third, you will identify potential losers from currency appreciation and present cases of actual losers from currency appreciation.

Part 1 - Identifying the Impact of Politically Based Currency Fluctuations

Imagine that a U.S. presidential candidate makes the following statement: "The United States must strengthen the dollar against other currencies. The United States must also reduce its trade deficit."

Will U.S. voters support these statements? Why or why not?

What is the economic benefit of strengthening the U.S. dollar?

What is the benefit of reducing the U.S. trade deficit?

Is it likely that the United States will simultaneously achieve these goals? Explain your reasoning.

Part 2 - Determine the Impact of Economic Currency Fluctuations

A portfolio investor anticipated that during December of 2019, the Canadian dollar would appreciate relative to the United States dollar. The investor purchased 25,000 in Canadian dollars (CAD) on December 2, 2019. Use the data on foreign exchange rates at this webpage (hawkes.biz/ExchangeRates) to answer the following questions.

How much did the portfolio investor purchase in CAD on December 2, 2019?

Holding all other factors constant, exactly what profit or loss would the portfolio investor earn after purchasing United States dollars on December 31, 2019?

Was this an attempt at arbitrage or hedging? Be sure to explain your answer.

Complete the following chart by determining whether the scenario is expected to cause an increase, decrease, or no change for each of the three columns.

Determinant Change	Change in Demand for Canadian Dollar	Change in Supply of Canadian Dollar	Exchange Rate of Canadian Dollar (CAD/USD)
Financial experts featured on popular news networks predict that the Canadian dollar will depreciate relative to the U.S. dollar.			
Real interest rates for Canadian securities are expected to exceed that of the United States.			
Inflation rates in Canada have been higher than anticipated, while inflation in the U.S. has remained on target.			

Part 3 - Researching the Losers of Currency Appreciation

Provide at least three examples of how a United States firm can be harmed by currency appreciation of the U.S. dollar.

Conduct research and, for each example in your previous answer, provide specific examples of U.S. firms that were harmed by a stronger dollar. Don't forget to cite or provide links to sources.

Exchange your answers for Part 3 with a classmate.

Name of classmate you exchanged responses with:

Did your classmate cite a negative consequence of a strong dollar that you did not provide in your response?

Out of the examples shared by your classmate, which did you find to be most interesting and applicable to Chapter 29?

Checklist

Part 1

- ☐ Consider the fictional statements.
- ☐ Consider expected responses to the statements.
- ☐ Consider the economic effect(s) of the statements.
- ☐ Consider the likelihood of the statements.

Part 2

- ☐ Calculate the effect of appreciation.
- ☐ Determine if the scenario represents arbitrage or hedging.
- ☐ Determine the effect on the Canadian dollar based on different determinants.

Part 3

- ☐ List three risks or negative effects of currency appreciation.
- ☐ Research examples of the negative effects of appreciation.
- ☐ Evaluate a classmate’s findings.