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SUBJECT: ECONOMICS

GRADE 12

AUTUMN CLASSES

TEACHER AND LEARNER CONTENT MANUAL

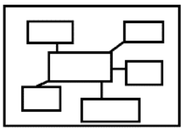
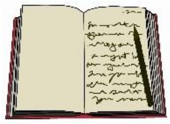
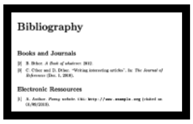
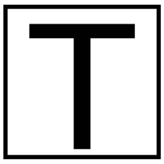
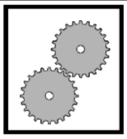
Topic

FOREIGN EXCHANGE MARKETS

JENN MAREMATLOU TRAINING INSTITUTE

A Division of Marematlou Group Holdings

ICON DESCRIPTION

 MIND MAP	 EXAMINATION GUIDELINE	 CONTENTS	 ACTIVITIES
 BIBLIOGRAPHY	 TERMINOLOGY	 WORKED EXAMPLES	 STEPS

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EXAM GUIDELINES

TOPIC 4: FOREIGN EXCHANGE MARKETS	CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES
<u>Examination</u> of the foreign exchange market, the establishment of exchange rates, and show how the Balance of Payments Account is affected	(Focus: Reasons for and effects of international trade, balance of payments, foreign exchange, foreign exchange markets and the correction of disequilibria in the foreign exchange market)
4.1 The main reasons for international trade	• ***Discuss in detail the reasons for international trade*** **Demand reasons:** - **Size of population** - **Income levels** - **Change in the wealth of the population** - **Preferences and taste** - **The difference in consumption patterns** - **Absolute and Comparative advantage Supply reasons:** - **Natural resources** - **Climatic conditions** - **Labour resources** - **Technological resources** - **Specialisation** - **Capital** • Briefly discuss the following **effects** of international trade: - Specialisation - Mass production - Efficiency - Globalisation

4.2 The Balance of Payments	• Briefly describe the **concepts** • Explain the value/purpose of the BoP • *Discuss the **composition** of the **current BoP** (which changed recently) in terms of the different accounts. Each item within the accounts should be explained. **1. CURRENT ACCOUNT** Goods exports + Net gold exports + Services receipts + Income receipts less Merchandise imports less Payment for services less Income payments Current transfers (net receipts) Balance on Current Account Memo item: trade balance **2. CAPITAL TRANSFER ACCOUNT** **NET LENDING TO (+) OR BORROWING FROM (-) REST OF THE WORLD** **3. FINANCIAL ACCOUNT** Net direct investment Net portfolio investment Net financial derivatives Net other investments Reserve assets (SDR allowances) **Balance on Financial Account** Memo item: balance on Financial Account excluding reserve assets. Unrecorded transactions

4.3 Corrections of Balance of Payments surplus and deficit (disequilibria)	• Discuss the different **measures to correct** the BoP surplus and deficit (disequilibria): - Interest rates - Import controls - Borrowing and lending - Change in demand - Export promotion - Import substitution - Change in exchange rates
4.4 Foreign exchange markets	• Describe the **concepts** (types of exchange rates, appreciation, depreciation, devaluation, revaluation, **foreign exchange control**) • Supply and demand of foreign exchange - Factors affecting demand - Factors affecting supply - Exchange rate **equilibrium** (draw and interpret graphs) - **Changes** to equilibrium (draw and interpret graphs) - Briefly explain **interventions** in the market
4.5 The establishment of foreign exchange rates	• Briefly explain the following **exchange rate systems:** - Free floating (linked to South Africa) - Managed floating - Fixed • Describe the **terms of trade** under the following headings: - Description - Formula - The effect on the economy

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The main reasons for international trade

International trade	Exchange of goods and services and capital across the borders
Demand	The desire and willingness to buy a specific good at a specific price.
Supply	Total quantity of goods or services that producers are willing and able to offer to a market at various price levels.
Consumption	The purchase and use of goods and services by households to satisfy needs and wants.
Income levels	Categories of money earned by individuals or households over a period of time
Absolute advantage	When a country or firm can produce more goods or services than competitors using the same amount of resources.
Comparative advantage	The ability to produce goods or services with lower opportunity cost than its trading partners
Globalization	The worldwide interaction of economies, with trade as a key element

1.1 REASONS FOR INTERNATIONAL TRADE

International trade happens because no country can produce all the goods its people want or need. Differences in population size, income, tastes, resources, and technology create gaps that trade helps to fill. Countries also specialise in what they do best and rely on others for what they cannot produce efficiently. For these reasons, nations trade to improve choice, reduce costs, and support economic growth. Below are reasons that necessitates trade between countries:

Demand Reasons

1) Size of the Population

- When a country has a large population, it often cannot produce enough goods for everyone, so it must import goods from other countries.
- When a country has a small population, local producers may not sell enough products at home, so they export to bigger markets to survive.

2) Income Levels

- When people earn higher incomes, they demand a wider variety of goods, including products their country does not make, which increases imports.
- When incomes are low, people look for cheaper goods, and importing low-cost products becomes necessary

3) Changes in Wealth

- When the wealth of a population increases, people start demanding luxury or high-quality goods, which forces the country to import items it does not produce locally.
- Even when wealth decreases, international trade is still needed because people turn to cheaper foreign products.

4) Preferences and Taste

- People often develop preferences for foreign brands, food, fashion, and technology, which makes importing necessary to satisfy consumer tastes.
- As tastes change internationally, countries with popular products export more to meet this global demand.

5) Differences in Consumption Patterns

- Countries have different cultural habits and lifestyles, which create demand for goods that may not be produced locally, making imports essential.

Supply Reasons

1) Natural Resources

- Natural resources such as oil, minerals, and timber are not evenly spread across countries, so nations must trade to get the resources they lack.
- Countries that have a surplus of certain resources export them to earn income and support global production.

2) Climatic Conditions

- Different climates make it possible for some countries to grow or produce goods that others cannot, such as coffee, tea, or tropical fruits.
- Countries import products that their climate does not support, and export goods suited to their own climate.

3) Labour Resources

- Countries with many workers or low labour costs can produce labour-intensive goods more cheaply, which encourages them to export.
- Countries with highly skilled labour produce advanced goods that other countries must import to access that expertise.

4) Technological Resources

- Countries with advanced technology can produce high-quality or complex goods that many other countries cannot make, so they become major exporters.
- Countries with less technology must import these technologically advanced goods to support their industries and consumers.

5) Specialisation

- When a country focuses on producing what it is best at, it becomes efficient and produces more than it needs, which leads to exports.
- Because countries specialise, they must import the goods they choose not to produce.

6) Capital

- Wealthier countries with strong capital resources can afford advanced machines and factories, which help them produce capital-intensive goods for export.
- Countries with less capital must import machinery, equipment, and other production tools to grow their industries

Absolute and Comparative Advantage

- If another country produces more of a product or service than competitors, using the same or fewer resources then it has **absolute advantage** in that production. For example, if South Africa can produce 50kgs of maize per hour and Botswana can only produce 25kgs of maize then South Africa has an absolute advantage in maize production.

- If a country produces a good at a lower cost than competitor, it is said to produce at a **comparative advantage**. For example, China has comparative advantage in manufacturing due to lower labour costs which is lower opportunity cost than many countries. While South Africa has a comparative advantage in mining due to its vast mineral wealth.
- Countries trade because each one focuses on the goods it produces best, and imports what others produce more efficiently

EFFECTS OF INTERNATIONAL TRADE

1) Specialisation

- International trade encourages countries to focus on producing the goods they are best at making.
- This helps countries use their resources more effectively and improve the quality of their products.

2) Mass Production

- Because countries sell to global markets, they produce goods on a much larger scale.
- Mass production lowers the cost per unit, making goods cheaper for consumers.

3) Efficiency

- Trade pushes businesses to improve their skills, technology, and processes to stay competitive.
- This leads to better productivity and lower production costs.

4) Globalisation

- International trade connects countries through the exchange of goods, services, ideas, and culture.
- This creates a more integrated world where economies depend on one another.

ACTIVITY 1

1.1
- Discuss in detail the demand reasons for international trade. (26)
- How does the manipulation of the rand affect the foreign exchange market? (10)

TOTAL 40 MARKS

ACTIVITY 2

2.1

2.1.1 Identify the indirect tax depicted on the picture above. (1)

2.1.2 Name the good that Mexico specializes with. (1)

2.1.3 Describe the term *mass production*. (2)

2.1.4 Briefly explain how does the use of technological resources affect the demand of international goods. (2)

2.1.5 How does a country benefit from efficiency in production? (4)

2.2 Differentiate between comparative and absolute advantage. (8)

TOTAL 18 MARKS

Balance Of Payment

Balance of payment	It is the difference in value between a country's imports of goods and exports of goods
Current account	represents a country's imports and exports of goods and services, payments made to foreign investors, and transfers such as foreign aid.
Trade deficit	It is the amount by which the value of a country's imports exceeds the value of its exports
Trade surplus	Trade surplus is the amount by which the value of a country's exports exceeds the value of its imports
Merchandise exports	Amount of goods sold to other countries
Merchandise imports	Amount of goods bought from other countries
Capital transfer account	consist of transfers of ownership of fixed assets; transfers of funds
Net Gold exports	Value of gold exported minus the value of gold imported
Services receipts	Payment received for services provided to other countries
Payment services	Payments made for services rendered by other countries

1.2 THE BALANCE OF PAYMENTS (BoP)

The Balance of Payments (BoP) is a record of all financial transactions between a country and the rest of the world during a specific period. It includes money coming in (Receipts) and money going out (Payments), and it helps show how the country interacts with the global economy.

The Value / Purpose of the BoP

- The BoP helps a country understand its **economic position**, such as whether it is earning more from other countries or spending more abroad.
- It indicates **strengths and weaknesses** in the economy, such as trade deficits or surpluses.
- Policymakers use it to make decisions on trade, exchange rates, and economic planning

The Composition of the Current Balance of Payment.

The BoP is made up of three main accounts namely:

1. Current Account
2. Capital Account
3. Financial Account

1.2.1 CURRENT ACCOUNT

This account records the flow of goods, services, income, and transfers between a country and the rest of the world

Current account (R Millions)
Merchandise exports
Net gold exports
Services receipts
Income receipts
Merchandise imports
Payment for services
Income payments
Current transfers
Balance on current account
Memo item: Trade balance

Simplified version of the current account and brief explanations are listed in the table below.

Item	What It Means	Receipt (Money In){+}	Payment (Money Out){-}
Merchandise Exports	Goods SA sells abroad	Money received	-
Net Gold Exports	Gold sold minus gold imported	Money from gold exports	Money for gold imports
Services Receipts	Money earned from services	Foreigners pay SA	-

Income Receipts	Earnings from foreign investments	Money from abroad	-
Merchandise Imports	Goods SA buys	-	Money paid for imports
Payment for Services	Money paid for foreign services	-	Money paid abroad
Income Payments	Money paid to foreign investors	-	Dividends/interest paid
Current Transfers	One-way payments	Transfers received	Transfers sent
Balance on Current Account	Total credits minus debits	Surplus if >0	Deficit if <0
Trade Balance	Exports minus imports	Surplus if exports > imports	Deficit if imports > exports

Note: Learners must be able to explain each item listed on this current account

(Explanation of each item is listed below)

1. Merchandise Exports **(+)**

- These are physical goods (like minerals, cars, machinery, and agricultural products) that South Africa sells to other countries. Money received from these exports is recorded as credit (money coming into the country).

2. Net Gold Exports **(+)**

- This is the value of gold sold to other countries, minus the value of any gold imported. Since South Africa is a major gold producer, this item often adds positively to the current account.

3. Services Receipts **(+)**

- This includes money earned from services provided to foreign countries, such as tourism, transport, banking, engineering, and consulting. It is recorded as credit because the country receives money.

4. Income Receipts **(+)**

- This is income earned by South African residents from overseas investments, such as dividends from foreign shares, interest from foreign bonds, or profits earned by South African companies operating abroad.

5. Merchandise Imports **(-)**

- These are physical goods that South Africa buys from other countries. Money paid for these goods is recorded as a debit (money leaving the country).

6. Payment for Services **(-)**

- This includes money paid by South Africans for services provided by foreign firms, such as foreign travel, international shipping, insurance, or foreign consultancy. It is a debit entry.

7. Income Payments **(-)**

- This is money paid to foreign investors who have invested in South Africa. It includes dividends, interest, and profits that leave the country.

8. Current Transfers **(+/-)**

- These are one-way payments where nothing is received in return. Examples include remittances, donations, foreign aid, and gifts between countries or individuals. Transfers received are added (+) while transfers paid are subtracted (-).

9. Balance on Current Account

- This is the overall result of all the current account items (exports, imports, services, income, and transfers).
  If credits are greater than debits → surplus
  If debits are greater than credits → deficit

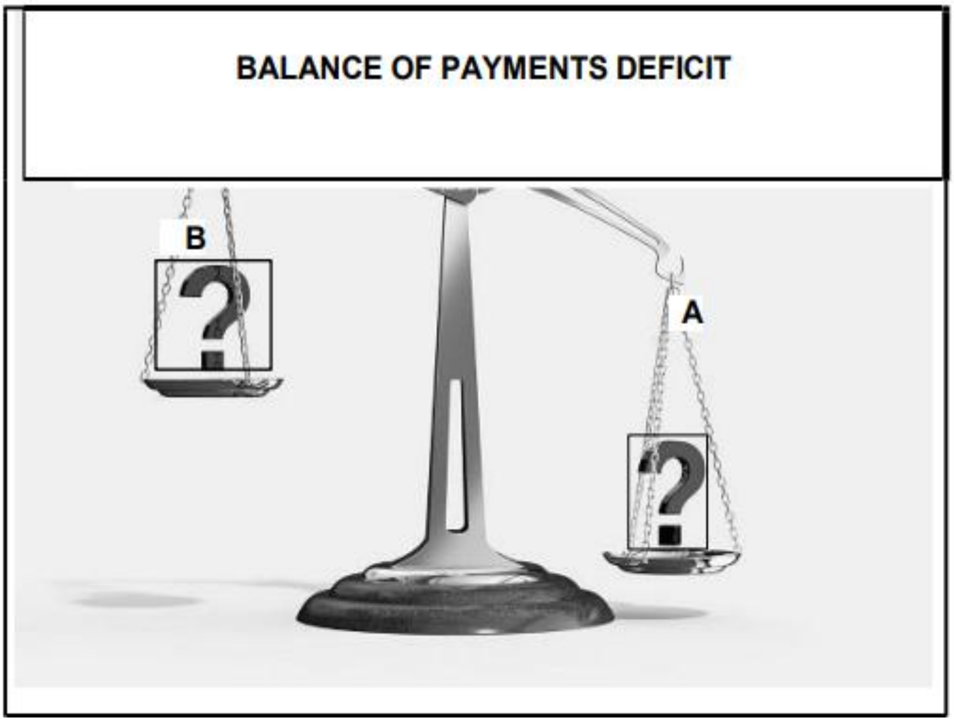
10. Memo Item: Trade Balance

- The trade balance is the difference between merchandise exports and merchandise imports only.
  Formula: Merchandise exports + Gold exports – Merchandise imports

- If exports > imports → trade surplus
- If imports > exports → trade deficit.

ACTIVITY 3

3.1 Study the Picture below and answer the questions that follow.



[Adapted from https://ecoaim.in/2020/07/12/how-disequilibrium-can-be-corrected/.

3.1.1	Which letter represents imports from the above data?	(1)
3.1.2	Which international institution can help countries with funds to correct fundamental deficit.	(1)
3.1.3	Briefly describe the term *balance of payment*.	(2)
3.1.4	Explain the relationship between the exchange rate of a country and its balance of payment.	(2)
3.1.5	Why is it important to analyse a country's balance of payment data?	(2x2) (4)

TOTAL 10 MARKS

ACTIVITY 4

4.1 Study the information below and answer questions that follow

BOP CURRENT ACCOUNT

R billions	2023	2024				
Seasonally adjusted and annualised	Year	Q1	Q2	Q3	Q4	Year
Current account credits (Receipts)						
Goods and services	2 301	2 332	2 396	2 279	2 340	2 337
Exports of goods	2 038	2 050	2 114	1 982	2 033	2 045
Merchandise exports (free on board)	1 922	1 938	1 963	1 843	1 836	1 895
Net gold exports	116	113	151	139	197	150
Services receipts	263	281	282	297	307	292
Primary income receipts	217	196	196	194	198	196
Secondary income (current transfers) receipts	76	78	81	84	94	84
Current account debits (Payments)						
Goods and services	2 278	2 191	2 255	2 145	2 169	2 190
Merchandise imports (free on board)	1 934	1 844	1 888	1 782	1 800	1 828
Services payments	343	347	368	363	369	362
Primary income payments	312	352	313	336	362	341
Secondary income (current transfers) payments	115	124	133	132	132	130
Balances (Net transactions: receipts less payments)						
Trade balance (goods)	***103***	***206***	***226***	***200***	***233***	***216***
Balance on trade in services	- 80	- 66	- 85	- 66	- 62	- 70
Balance on goods and services	23	140	141	134	171	147

[Adapted from SARB QB, March 2025]

4.1.1 Give the economic concept illustrated in the table above. (1)

4.1.2 Which current account item is used for recording donations? (1)

4.1.3 Briefly describe the term *trade balance*. (2)

4.1.4 Why are net gold export figures positive in South Africa? (2)

4.1.5 What impact will the deficit on current account have on the economy? (2x2)(4)

TOTAL 10 MARKS

1.2.2 CAPITAL ACCOUNT

The capital account records capital transfers and the buying or selling of non-produced and non-financial assets. It is usually the smallest of the three accounts.

1) Capital Transfers

This includes things like the forgiveness of debt or transfer of ownership of fixed assets.

2) Non-Produced, Non-Financial Assets

These include items like patents, trademarks, mineral rights, or other intangible assets.

1.2.3 FINANCIAL ACCOUNT

The financial account records all transactions involving investments between countries. It shows how money moves for investment purposes.

1. Net Direct Investment

- This shows the difference between money flowing into the country and money flowing out for direct investments, such as when companies buy or expand businesses in another country.
- Inflow example: A foreign company builds a factory in South Africa.
- Outflow example: A South African company buys a business overseas.

2. Net Portfolio Investment

- This is the balance between foreign buying of South African shares, bonds and derivatives and South Africans buying foreign shares, bonds and derivatives.
- Portfolio investments are regarded as *hot money* because they can be quickly turned into cash.
- Inflow: Foreigners invest in the JSE or SA government bonds.
- Outflow: South Africans invest in foreign stock markets.

3. Net Financial Derivatives

- This records transactions involving financial contracts such as futures, options, and swaps.
- These instruments gain or lose value based on future prices.
- The net figure shows whether South Africans owe money or receive money from these derivative contracts.

4. Net Other Investments
    - These are all other forms of international financial flows not counted under direct investment, portfolio investment, or reserve assets.
    - They include Loans between countries or banks deposits made in foreign or local banks
    - Trade credit (money owed for imported/exported goods)
5. Reserve Assets (including SDR allocations)
    - These are foreign currency reserves, gold reserves, International Monetary Fund (IMF) Special Drawing Rights (SDRs), and other assets held by the South African Reserve Bank.
    - When reserve assets increase, it is recorded as a debit because SA is using rands to buy foreign assets.
    - When they decrease, it is a credit because SA sells foreign assets to bring money into the country.
6. Balance on Financial Account

- This is the overall result of all financial flows (direct, portfolio, derivatives, other investments, and reserves).
- A positive balance means more money is flowing into the country for investment.
- A negative balance means more money is flowing out.

7. Memo Item: Balance on Financial Account **Excluding Reserve Assets**

- This shows the balance on the financial account without **counting reserve assets.**
- It helps policymakers see whether investment flows alone (excluding central bank activity) are strong or weak

- This can be done by adding positive values and subtracting negative values without taking into account the assets like SDR's

8. Unrecorded Transactions

- This is an adjustment item used to correct errors, missing data, or timing differences in the BoP. because international transactions are massive and recorded by many institutions, some entries may be incomplete.
- This item ensures that the Balance of Payments still balances overall.

ACTIVITY 5

5.1 Study the table below and answer the questions that follow.

R MILLION

Capital transfer account	**+241**
Net direct investment	12 900
Net portfolio investments	54 477
Other investments	107 688
Balance on financial account	175 065
Unrecorded transaction	-1 801
Changes in Net gold and foreign reserves	**?**

5.1.1 Identify the type of account in the balance of payment from the above t (1)

5.1.2 Which investment depicts the buying and selling of foreign shares and bonds (1)

5.1.3 Briefly describe the term *Non-financial assets* (2)

5.1.4 Explain the purpose of unrecorded transactions. (2)

5.1.5 If the balance on current account was -R164 548, calculate the value for "changes in Net Gold and other foreign reserves. Show all calculations. (4)

TOTAL 10 MARKS

ACTIVITY 6

6.1 Study the table below and answer the questions that follow.

BALANCE OF PAYMENTS (BOP)
THE FINANCIAL ACCOUNT

Item	2022 (R millions)
Net direct investment	32 367
Net portfolio investment	-4 688
Net financial derivatives	-3 465
Net other investments	9 594
Reserve assets (SDR allowances)	-35 241
Balance on Financial Account	**-1 433**
Memo item: Balance on Financial Account, excluding reserve assets	**A**

[Source: *SARB, Quarterly Bulletin*, September 2022]

6.1.1 Identify the item that records an investment made in a specific asset with a fixed future value, such as gold. (1)

6.1.2 Name the item that caters for any omissions and errors in the balance of payments. (1)

6.1.3 Briefly describe the term *portfolio investment.* (2)

6.1.4 Explain the purpose of Special Drawing Rights (SDR) allowances in reserve assets. (2)

6.1.5 Use the information in the table above to calculate the memo item (A). Show ALL calculations. (4)

TOTAL 10 MARKS

T

Corrections of Balance of Payments

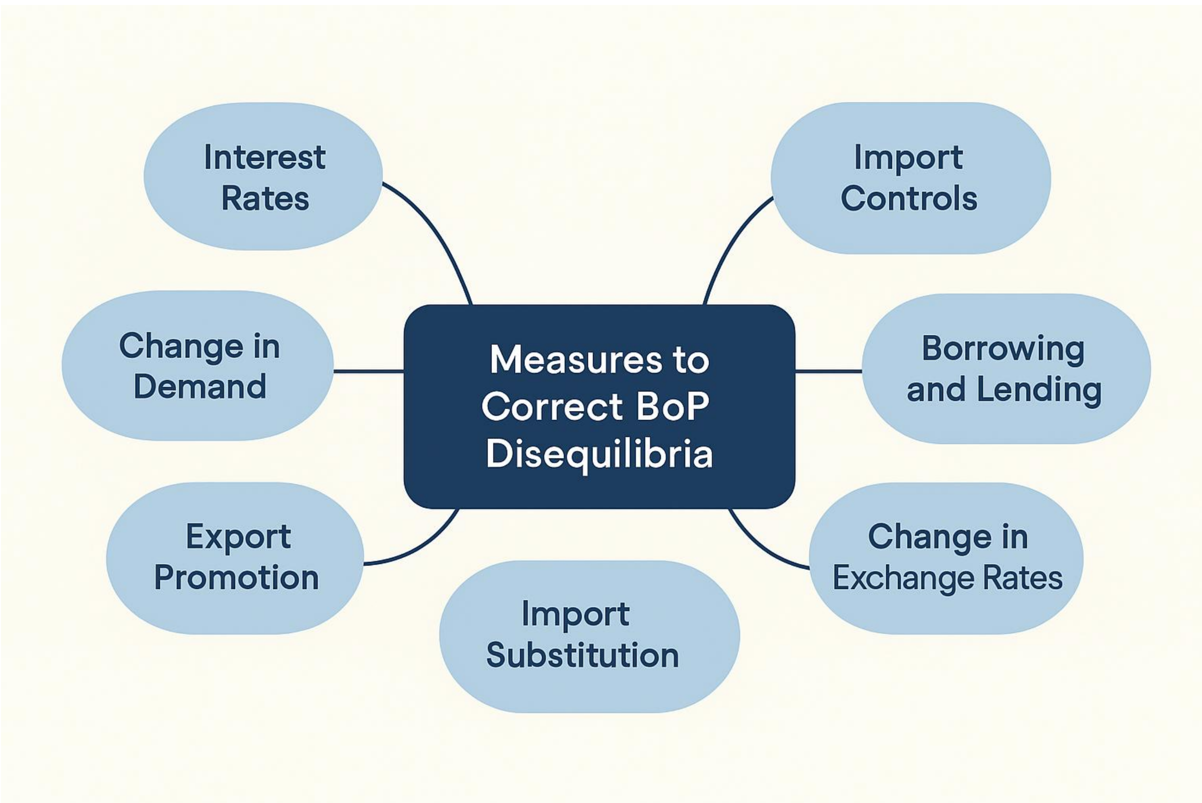
Interest rates	The cost of borrowing money or reward for saving it, expressed in terms of percentage. E.g. commercial bank charges interest rates on individuals
Deficit	Occurs when expenditure exceeds revenue, which represents negative balance.
Surplus	Occurs when revenue exceeds expenditure.
Import controls	Government imposed policies such as tariffs, quotas and licensing that regulate or limit the amount of goods entering the country/imports
Borrowing	Obtaining funds from a lender, with a formal agreement to repay the amount plus interest.

Lending	Providing funds to individuals, businesses / government to meet financial needs
Export promotion	Government policies designed to stimulate, support and increase a country's export sales.
Import substitution	An economic strategy used to promote the production of domestic goods to replace imports. It promotes industrialization.

1.3 CORRECTING BALANCE OF PAYMENTS DISEQUILIBRIUM

A Balance of Payments (BoP) disequilibrium happens when the total money flowing into a country is **not equal** to the total money flowing out over a period of time. Meaning if a country spends more on imports, foreign payments, and investments abroad than it earns, it has a BoP deficit and if a country earns more from exports, tourism, and foreign investments than it spends, it has a BoP surplus.

A disequilibrium means the BoP is not balanced, and the country may need to take action to correct it. The following instruments may be used to correct the balance of payment disequilibrium:.



Measures to Correct BoP Surpluses and Deficits (Disequilibria)

1. Interest Rates

- When a country raises interest rates, it attracts foreign investors who want higher returns. This brings more foreign currency into the country, helping to reduce the BoP deficit.
- Lowering interest rates can reduce capital inflows if a country has a BoP surplus and needs to avoid too much foreign money entering the economy.

2. Import Controls

- Governments may use tariffs, quotas, or stricter import regulations to reduce the amount of foreign goods entering the country.
- By reducing imports, the country spends less foreign currency, helping correct a BoP deficit

3. Borrowing and Lending

- A country experiencing a BoP deficit can borrow from international organisations (like the IMF) or foreign governments to stabilise its foreign reserves.
- A country with a BoP surplus may lend money to other nations, reducing the excess foreign currency inflow.

4. Change in Demand

- Governments may use policies that discourage demand for imports (e.g., taxes, awareness campaigns) so consumers buy more local goods.
- They may also encourage higher foreign demand for local goods, which increases exports and helps correct a deficit.

5. Export Promotion

- Governments can support industries by giving subsidies, tax incentives, or marketing assistance to help them sell more products abroad.
- More exports mean more foreign currency entering the country, helping to correct a BoP deficit and strengthen the economy.

6. Import Substitution

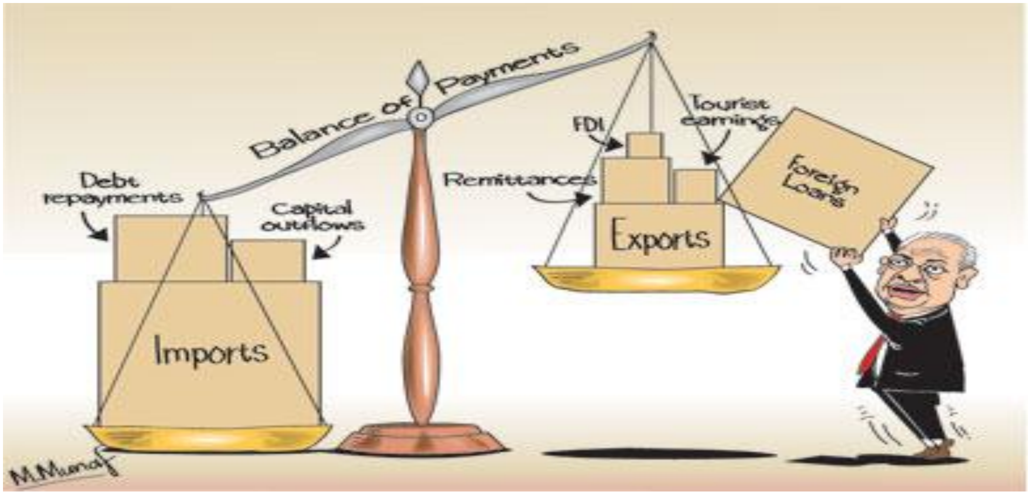
- This strategy encourages local production of goods that were previously imported.
- By replacing imports with locally produced items, the country reduces the outflow of foreign currency and improves the BoP position.

7. Change in Exchange Rates

- If the country depreciates its currency (allows it to weaken), exports become cheaper for foreigners and imports become more expensive.
- This helps correct a BoP deficit because exports rise and imports fall.
- If the currency appreciates (strengthens), it can help reduce a BoP surplus by making imports cheaper and exports more expensive.

ACTIVITY 7

7.1 study the cartoon below and answer the following questions.



7.1.1	Which concept is depicted by the cartoon above?	(1)
7.1.2	What does FDI stand for?	(1)
7.1.3	What does balance of payment disequilibria mean?	(2)
7.1.4	Describe the use of import control to correct BOP disequilibria.	(2)
7.1.5	Discuss any two methods of correcting BOP disequilibria.	(2X2(4)
	TOTAL	10 MARKS

T

FOREIGN EXCHANGE MARKETS

Foreign exchange	Global market for trading national currencies, enabling international trade.
Foreign exchange market	Markets that are engaged in buying and selling of foreign exchange.
Foreign exchange rate	The price of one country's currency in terms of another.
Appreciation	Increase in the value of currency over time, relative to another
Depreciation	Decrease in the value of currency over time in terms of another
Devaluation	Deliberate downward adjustment of a country's official currency, relative to another
Revaluation	Deliberate upward adjustment of a country's currency value relative to a benchmark
Equilibrium point.	It is the specific rate where the quantity of a currency demanded equals the quantity supplied.

Foreign exchange markets - Current leading markets in forex are New York, London, Hong Kong & Singapore

A **foreign exchange rate** – it is expressed (quoted) as the domestic price of one unit of a foreign currency, for example, $1=R10.00.

1. Appreciation

- Appreciation means the currency becomes stronger compared to other currencies in a floating exchange-rate system.. This means you can now buy more foreign currency with the same amount of your currency.
- Usually caused by high **demand** for the local currency.

Example:

If R1.00 could buy $0.05 before, and now it buys $0.06 → the rand has appreciated.

2. Depreciation

- Depreciation means the currency becomes weaker in a floating exchange-rate system. This means you can now buy less foreign currency with the same amount of your currency.
- Usually caused by low demand for the local currency.

Example:

If R1.00 bought $0.05 and now buys $0.04 → the rand has depreciated.

Key point:

It is caused by the **market forces** of demand and supply, not government intervention.

3. Devaluation

- Devaluation is when the government purposely lowers the value of its currency in a fixed exchange-rate system.
- This makes exports cheaper and imports more expensive.

4. Revaluation

- Revaluation is the opposite of devaluation.
- It happens when the government raises the value of its currency in a fixed exchange-rate system.
- Imports become cheaper; exports become more expensive

Key point:

It is a **deliberate government action**, not market forces

6. Foreign Exchange Control

- These are government rules that restrict or manage the buying and selling of foreign currency.
- Used to protect the country's BoP, control inflation, or stabilise the currency.

Examples include: Limits on how much foreign currency citizens can buy

- Permission required for large international transactions
    - Restrictions on sending money abroad

SUPPLY AND DEMAND OF FOREIGN EXCHANGE

1. Demand for Foreign Exchange

The demand for foreign currency comes from people and businesses who need to pay for foreign goods, services, or investments.

Factors affecting the demand for foreign exchange

a) Imports of Goods and Services

- When South Africans buy foreign goods (e.g., electronics, oil, cars), they need foreign currency to pay for them.
- More imports → higher demand for foreign exchange.

b) Foreign Travel

- When South Africans travel abroad, they need foreign currency for accommodation, food, transport, and entertainment.
- More travel → more demand for foreign currency.

c) Investment Abroad

- When South African companies or individuals invest in foreign shares, property, or businesses, they need foreign currency to do so.
- More overseas investment → higher demand for foreign exchange.

d) Payment of Income to Foreigners

- Foreigners who invested in South Africa must be paid dividends, profits, and interest in their home currency.
- These payments increase the demand for foreign currency.

e) Speculation

- If investors expect a foreign currency to strengthen in future, they buy more of it now.
- This increases demand for foreign exchange.

2. Supply of Foreign Exchange

The supply of foreign exchange refers to the amount of foreign currency entering the country. It increases whenever foreigners pay South Africans.

Factors affecting the supply of foreign exchange

a) Exports of Goods and Services

- When South Africa sells goods like minerals, fruit, machinery, or tourism services to foreigners, they pay in foreign currency.
- More exports → more supply of foreign exchange.

b) Foreign Investment into South Africa

- If foreigners buy South African shares, property, or businesses, they bring foreign currency into the country.
- More foreign investment → higher supply of foreign exchange.

c) Foreign Tourists Visiting South Africa

- Tourists spend money on accommodation, food, transport, and entertainment.
- Their spending brings foreign currency into the country.

d) Income Received from Abroad

- South Africans earning interest, profits, or dividends from foreign investments bring foreign currency home.
- More foreign income → more supply.

e) Foreign Aid or Transfers

- When South Africa receives foreign aid, donations, or remittances, this increases the supply of foreign currency.

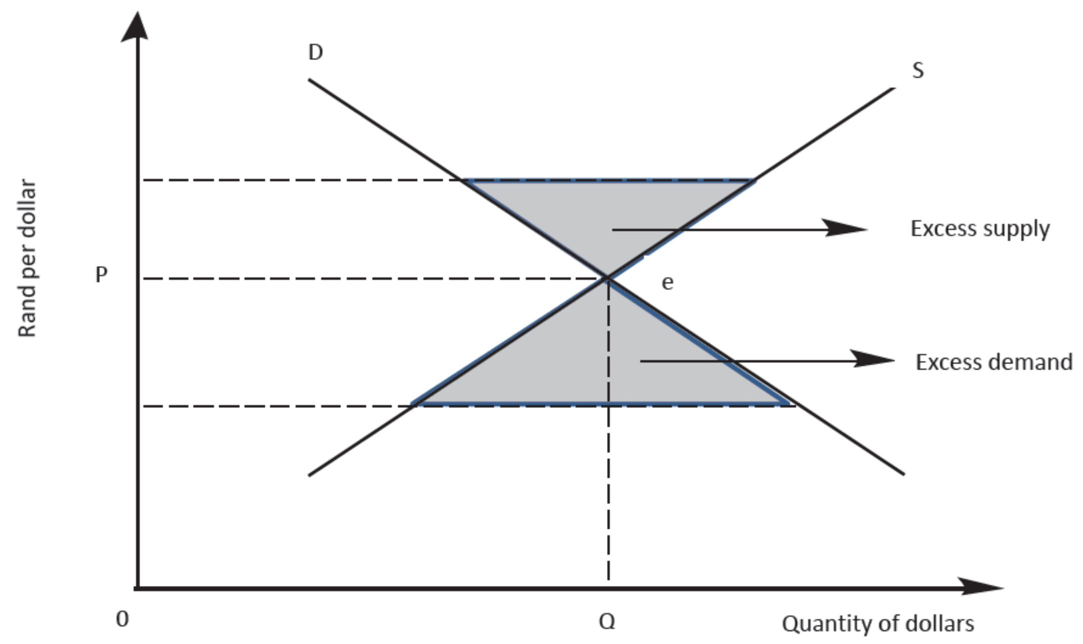
f) Speculation

- If investors expect the rand to strengthen, they sell foreign currency to buy rand.
- This increases the supply of foreign exchange.

Foreign Exchange Summary Table

Category	Description
Demand for Foreign Exchange	Created by imports, foreign travel, SA investing abroad, payments to foreign investors, and speculation.
Supply of Foreign Exchange	Created by exports, foreign tourists, foreign investment, income from abroad, aid, and speculation.

EXCHANGE RATE EQUILIBRIUM (DRAWING & INTERPRETATION OF GRAPHS)



1. Interpretation of the graph

- This graph shows the foreign exchange market where people buy and sell US dollars using South African rands (ZAR).
- Point e is where demand equals supply of dollars, **equilibrium point.**
- At this point, the exchange rate is stable.

2. Excess supply

- At a price higher than P, the Rand price of the dollar is too high.
- Americans and other foreigners bring more dollars into SA because they get more rands per dollar. However South Africans don't want to buy many dollars at that high price, this causes excess supply (too many dollars, not enough buyers).
- The market will force the price downward toward equilibrium.

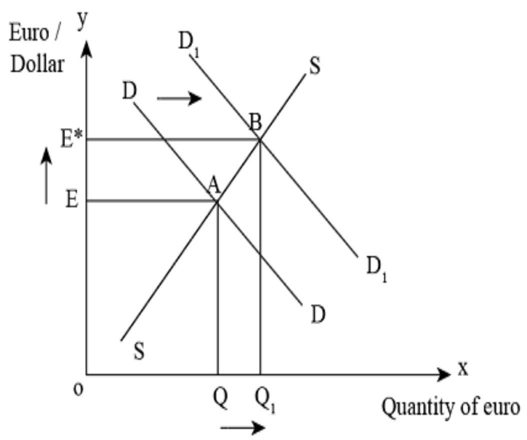
3. Excess demand

- At a price lower than P, the dollar becomes cheap for South Africans.
- South Africans want to buy more dollars (for imports and travel) but foreigners supply fewer dollars at that low price. So there is excess demand (too many buyers, not enough dollars).
- The market will push the price upward back to equilibrium.

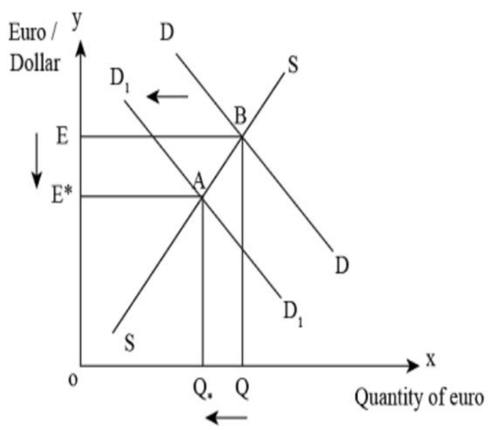
CHANGES TO EQUILIBRIUM (DRAW AND INTERPRET GRAPHS)

Changes in demand

Graph 1



Graph 2



1. Interpretation of the graph 1.

- The graph shows the shift in the demand curve of euros. It shows us what happens in the foreign exchange market when Americans want more euros.
- There is an increase in the demand for Euros, the demand curve shifts to the right from D to D1.

2. The original equilibrium (Point A)

- The original demand curve (D) meets the supply curve (S) at point A.
- This is considered a normal and stable exchange rate before demand changes

3. Demand increases → Demand curve shifts right (D → D1)

- The arrow on the graph shows the demand curve moving to the right.
- This means people are demanding more dollars at every price.
- On the graph, the new demand curve is D1

4. New equilibrium (Point B)

- After the demand curve shifts the new equilibrium point moves from A to B.
- At B, the price of the euro is higher, at E*.
- The quantity of euros traded also increases from Q to Q1.
- This shows that increased demand pushes the price of the euro up.

1. Interpretation of the graph 2.

- The graph shows the shift in the demand curve of euros. It shows us what happens in the foreign exchange market when Americans want less euros.
- There is a decrease in the demand for Euros, the demand curve shifts to the from D to D1.

. The original equilibrium (Point B)

- The original demand curve (D) meets the supply curve (S) at point B.
- This is considered a normal and stable exchange rate before demand changes

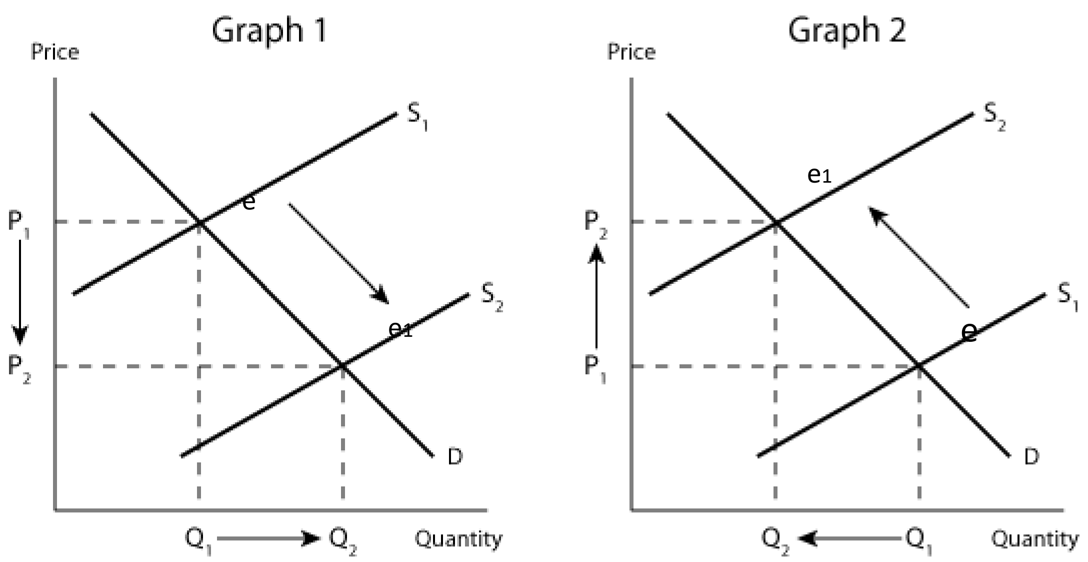
3. Demand decreases → Demand curve shifts left (D → D1)

- The arrow on the graph shows the demand curve moving to the left.
- This means people are demanding less euros at every price.
- On the graph, the new demand curve is D1

4. New equilibrium (Point A)

- After the demand curve shifts the new equilibrium point moves from B to A.
- At A, the price of the euro is cheaper, at E*.
- The quantity of euros traded also decreases from Q to Q*.
- This shows that decreased demand pulls the price of the euro down.

Changes in supply



Interpretation of the graph 1

- This graph explains what happens when more US dollars flow into South Africa. This could be due to more American tourists visiting South Africa or Americans invest more money in SA businesses.
- More dollars entering the country means the supply curve shifts to the right, from S1 to S2.

Original equilibrium (Point e)

- The foreign exchange market originally settles at point e.
- This is the starting stable exchange rate before supply changes.

Supply increases → Supply curve shifts right (S → S1)

- The arrow on the graph shows the supply curve shifting to the right.
- This means more dollars are available in the market at every price.
- On the graph, the new supply curve is S1.

New equilibrium (Point e1)

- Once supply increases: The equilibrium point moves from e to e1.
- This shows that more supply of dollars causes the dollar to weaken and the rand to strengthen.

Interpretation of the graph 2

- This graph explains what happens when less US dollars flow into South Africa.
- Less dollars entering the country means the supply curve shifts to the left, from S1 to S2.

2. Original equilibrium (Point e)

- The foreign exchange market originally settles at point e.
- This is the starting stable exchange rate before supply changes.

3. Supply decrease → Supply curve shifts left (S → S1)

- The arrow on the graph shows the supply curve shifting to the left.
- This means less dollars are available in the market at given price.
- On the graph, the new supply curve is S1.

4. New equilibrium (Point e1)

- Once supply decreases: the equilibrium point moves from e to e1.
- This shows that less supply of dollars causes the dollar to strengthen and the rand to weaken.

Interventions in the Market (Brief Explanation)

Market intervention happens when a country's central bank (like the South African Reserve Bank) takes action to influence the exchange rate instead of letting demand and supply determine it completely. Governments intervene to stabilise the currency, protect the economy, or correct BoP problems by:

1. Buying and Selling Foreign Currency

- If the rand becomes too weak, the central bank may sell foreign currency (e.g., dollars) and buy rands to strengthen the rand.
- If the rand becomes too strong, the central bank may buy foreign currency to weaken the rand and help exporters.

2. Changing Interest Rates

- Higher interest rates attract foreign investors → more foreign currency enters the country → the rand strengthens.
- Lower interest rates cause money to flow out → rand weakens.

3. Foreign Exchange Controls

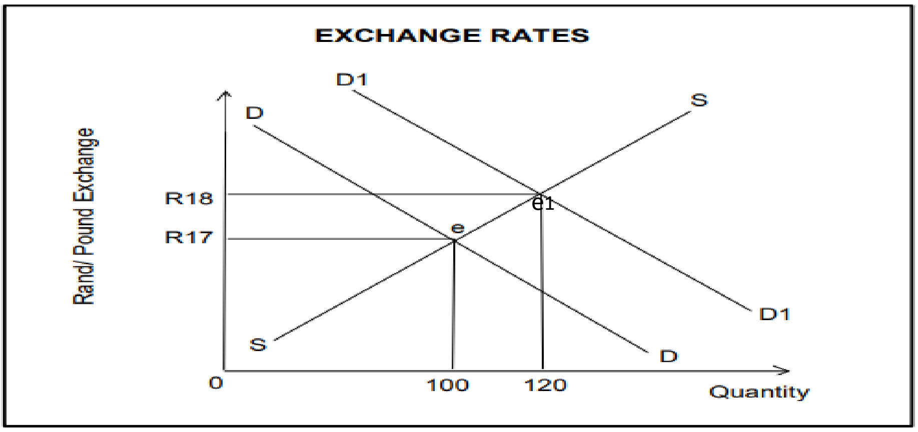
- The government can place limits on how much foreign currency citizens or companies may buy.
- This reduces the demand for dollars and protects the rand.

4. Borrowing or Using Reserves

- The central bank may use foreign reserves to support the currency or borrow foreign money during a crisis.
- This helps stabilise the exchange rate.

ACTIVITY 8

8.1 Study the graph below and answer the questions that follow



8.1.1 Identify the original equilibrium exchange rate in the above graph? (1)

8.1.2 What exchange rate system does South Africa currently use? (1)

8.1.3 Briefly describe the term currency (2)

8.1.4 Explain a reason for the increase in demand for the pound (2)

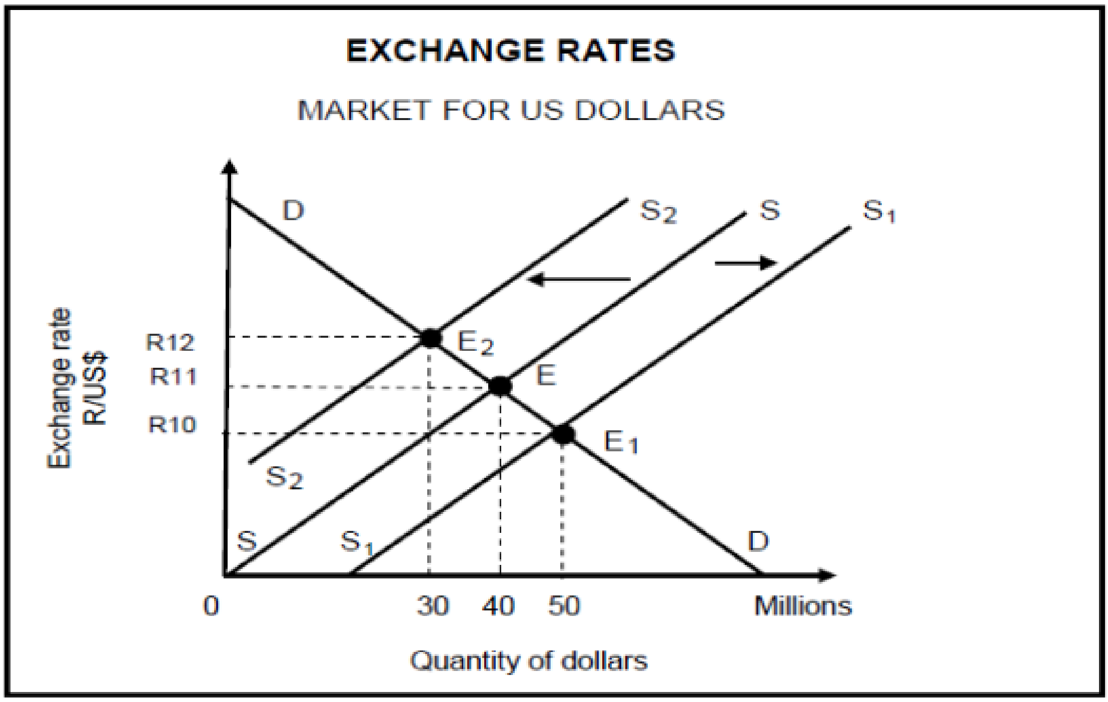
8.1.5 Use the graph above to illustrate depreciation of the Rand against the US dollar. (4)

8.1.6 Differentiate between managed floating and fixed economic system (8)

TOTAL: 18 MARKS

ACTIVITY 9

Study the graph below and answer the questions that follow



9.1.1	Name the exchange rate system in the graph above	(1)
9.1.2	Identify the foreign currency used in the market above.	(1)
9.1.3	Briefly describe the term *foreign exchange*	(2)
9.1.4	What could the SARB do to strengthen the value of the rand against the dollar?	(2)
9.1.5	Use the above graph to explain the effect of the increase in the supply of US dollars on the R/US$ exchange rate.	(4)

TOTAL: 10 MARKS

ACTIVITY 10

10.1 Briefly explain how the government intervenes to stabilise the currency/ economy. (4)

10.2 With an aid of a graph explain the increase in demand of foreign exchange (8)

10.3 With an aid of a graph explain the decrease in supply of foreign exchange (8)

TOTAL: 20 MARKS

T

EXCHANGE RATE SYSTEMS

Exchange rate systems	Defines how a country manages its currency's value relative to others
Free Floating exchange rate	A system where a currency's value is determined solely by the market forces of demand and supply .
Managed floating exchange rate	A system where a currency's value is primarily determined by the market forces of demand and supply, but with occasional intervention from the central bank.
Fixed exchange rate	A system where the government ties its currency's value to another major currency or commodity.

1.5 THE ESTABLISHMENT OF EXCHANGE RATE SYSTEMS

1. Free Floating Exchange Rate (like South Africa's)

- The value of the currency changes freely based on how much people want to buy or sell it.
- No one controls it — not the government, not the central bank.
- It can go up or down a lot depending on the economy, trade, or world events.

Think of it like: a price at a market that changes every minute depending on demand.

2. Managed Floating Exchange Rate

- The currency is mostly allowed to move up and down on its own, like a free float.
- BUT the central bank sometimes steps in to stop it from moving too much.
- They may buy or sell currency to keep things more stable.

Think of it like: a teacher letting learners work freely, but stepping in when things get out of control

3. Fixed Exchange Rate

- The currency's value is kept the same compared to another currency (like fixing it to the US dollar or rand).
- The government or central bank must constantly control the currency to keep it at that fixed value.
- This makes the currency very stable, but the country loses some freedom to set its own money policies.

Think of it like: tying your shoelaces together — you stay together, but you can't move freely.

ACTIVITY 11

11.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter (A–D) next to the question number

11.1.1 The foreign exchange market is best described as a:

A. Place where goods are traded

B. Market where currencies are bought and sold

C. Market for government bonds

D. Place where taxes are collected

11.1.2 free-floating exchange rate means the value of a currency is determined by:

A. The government only

B. A fixed agreement between countries

C. Supply and demand in the market

D. International banks only

11.1.3 Which of the following will lead to an increase in the demand for foreign currency?

A. Increase in exports

B. Decrease in imports

C. South Africans buying more goods from overseas

D. Increase in foreign tourists visiting South Africa

11.1.4 When the rand depreciates against the US dollar, it means:

A. You can buy more dollars with one rand

B. The value of the rand increases

C. The value of the rand falls compared to the dollar

D. The exchange rate stays constant

11.1.5 A fixed exchange rate system requires the central bank to:

A. Allow the currency to move freely

B. Increase taxes on imports

C. Buy and sell currency to maintain a set value

D. Stop international trade

11.1.6 The formula for Terms of Trade (TOT) is

A. Exports – Imports

B. Import prices ÷ Export prices × 100

C. Export prices ÷ Import prices × 100

D. Imports × Exports

11.1.7 If a country's Terms of Trade improve, it means:

A. Export prices fall and the country is worse off

B. Import prices rise more than export prices

C. The country can buy more imports for the same exports

D. The exchange rate becomes fixed

11.1.8 A deficit on the Balance of Payments means

A. A country's exports are greater than its imports

B. More money is leaving the country than coming in

C. The exchange rate is fixed

D. A country's currency has appreciated

11.1.9 Which method can a government use to correct a Balance of Payments deficit?

A. Increasing imports

B. Reducing export subsidies

C. Decreasing interest rates to encourage spending

D. Devaluing the currency to make exports cheaper

11.10 Which item is recorded in the current account of the Balance of Payments?

A. Foreign investment in local businesses

B. Import and export of goods

C. Loans given to other countries

D. Financial transactions by multinational companies

11.1.11 A system where the value of a currency is tied to another currency or commodities

A. Managed floating exchange rate

B. Fixed exchange rate

C. Free floating rate

D. International rate

TOTAL 22 MARKS

T Terms of Trade

Terms of trade	Compare a country's export prices with its import prices by means of indexes

Terms of Trade

1. Description

- Terms of trade show the ratio between the prices a country receives for its exports and the prices it pays for its imports.
- It tells us whether a country can buy more or less from the world with the same amount of exports.

  In simple words:
- Terms of trade show how many imported goods a country can get in exchange for its exported goods.

2. Formula to calculate Terms of Trade.

$$\text{TOT} = \frac{\text{Index of Export Prices}}{\text{Index of Import Prices}} \times 100$$

3. Effect on the Economy

When Terms of Trade Improve (TOT increases)	**When Terms of Trade Worsen (TOT decreases)**
The country can buy more imports for the same amount of exports.	The country must export more to pay for the same amount of imports
Export earnings rise compared to import costs.	Import costs rise compared to export earnings
The country becomes better off.	The country becomes worse off.
Standard of living may increase.	Standard of living may fall.
Example: If South Africa's export prices go up (like gold or platinum), the country can afford more imported goods (like machinery or oil).	Example: If export prices drop but imported oil becomes more expensive, the country loses purchasing power.

ACTIVITY 12

12.1 Study the information below and answer questions that follow

SOUTH AFRICA: TERMS OF TRADE 2022			
Month	**Index of import prices**	**Index of export prices**	**Terms of Trade**
January	108,2	102,9	95,1
February	107,9	105,4	97,6
March	107,7	109,7	**A**

[Adapted from https://www.statssa.gov.za/publications/P01427/P01427March2022.pdf]

12.1.1	Identify the institution responsible for publishing the data above.	(1)
12.1.2	What is the trend in the index of import prices?	(1)
12.1.3	Briefly describe the concept *terms of trade*.	(2)
12.1.4	What can bring an improvement in the country's terms of trade?	(2)
12.1.5	Calculate the terms of trade for March 2022 (A). Show ALL calculations (4)	(4)

TOTAL: 10 MARKS

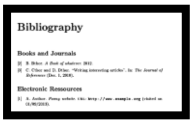
ACTIVITY 13

13.1.1	Name one major mineral that South Africa exports.	(1)
13.1.2	Define the term terms of trade	(2)
13.1.3	Identify the two elements/indexes used to assess terms of trade	(2)
13.2	Describe the consequences of changes in terms of trade.	(8)

TOTAL 13 MARKS

1.7 Conclusion

In conclusion, the foreign exchange market plays a vital role in connecting countries through trade, investment, and financial flows. It determines how one currency is valued against another, guiding the prices of imports and exports. Whether a country uses a free-floating, managed, or fixed exchange rate system, the goal is always the same: to keep the currency stable and support economic growth. Understanding how exchange rates work helps us see why currencies rise and fall, why countries trade the way they do, and how global events can influence our everyday lives. In the end, the foreign exchange market reminds us that no economy exists alone—every country is part of a much bigger global system.



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