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Class 12 commerce   Sub. ECO/B Date 23.01.2021

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Open Economy Macroeconomics

Q16. Why does demand for foreign exchange rises when price falls?

Ans. With a fall in price of foreign exchange, the exchange value of domestic currency increase and that of foreign currency falls. This implies that foreign goods becomes cheaper and their domestic demand increases. The rising domestic demand for foreign goods implies higher demand for foreign exchange. So there is relationship between price and demand for foreign exchange.

Q17. Give two examples and explain why there is a rise in demand for a foreign currency when its price falls.

Ans. When price of foreign currency falls, imports get cheaper. So, more demand for foreign exchange by importers. Toursim abroad is promoted as it becomes cheaper. So demand for foreign currency rises.

Q18. Distinguish between fixed and flexible foreign exchange rate.

Ans. When foreign exchange rate is fixed by central bank or government, it is called fixed exchange rate. When foreign exchange rate is determined by market forces/mechanism, it is flexible exchange rate.

Q19.Distinguish between autonomous and accommodating transaction of balance of payment account.

Ans. Autonomous transactions are done for some economic consideration such as profit, such transactions are independent of the state of balance of payment. Accomodating transactions are under taken to cover the deifcit or surplus in balance of payments.

Q20.What determines the flow of foreign exchange in to the country?

Ans. Below mentioned factors contribute the flow of foreign exchange into the country:-

1. Purchase of domestic goods by the foreigners

2. Foreign direct investment and portfolio investment in the home country

3. Speculative purchase of foreign exchange

4. Foreign tourists visits different places in India.