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value



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The Australian Exchange Rate By: Dontae Smith Introduction: What factors affect the demand and supply of Australian dollars in the foreign exchange markets? Distinguish between the possible causes and effects of currency depreciation and a currency appreciation on the Australian economy.

What forces have come into play, if any, in the past four months that have affected the value of the Australian dollar? Exchange Rate: The rate at which one unit of domestic currency is exchanged for a given amount of foreign currency A BRIEF HISTORY OF THE AUSTRALIAN DOLLAR Until 1971, the Australian dollar (AUD) was pegged to the British pound. This meant that the AUD rose or fell in line with the pound. In 1971, the AUD became pegged to the US dollar instead. These currencies were fixed currencies, which meant that the Australian currency would only change value when a major world currency also changed.

This system lasted only until 1974 when the AUD became pegged to a trade-weighted selection of other currencies. This was still a fixed currency. In 1976 this selection of currencies became moveable.

Small shifts were able to take place when needed. In 1983 the AUD became a floating currency. This means that the value of the dollar is determined by supply and demand. Initially, the Reserve Bank of Australia was not intended to intervene in the market however since then it has been deemed necessary for intervention to take place, usually to prop up the price.

FACTORS AFFECTING SUPPLY AND DEMAND OF AUSTRALIAN DOLLARS With a floating exchange rate, such as Australia's, supply and demand factors largely determine the dollar's equilibrium price. The exchange rate is

sensitive to changes in both demand and supply, which can cause changes in the equilibrium exchange rate.

Another factor, which can affect the supply and demand of Australian dollars, is intervention in the market by the Reserve Bank of Australia. DEMANDThe demand for Australias currency in the foreign exchange market (Forex) is a derived demand. It is derived from the demand for a countrys exports of goods and services and its assets. In simple terms, people who may have a demand for the Australian dollar could include: \_ Foreigners wanting to purchase Australian exports \_ International tourists visiting Australia \_ International investors wishing to purchase Australian shares or property \_ International firms setting up branches or expanding in Australia \_ Speculators and investors who think the value of the Australian dollar will rise in hope of making a profit.

The demand for the Australian dollar will be affected by a number of factors. These factors are: The Size of financial flows into Australia The size of financial flows into Australia from investors who wish to invest in Australia and need to convert their currency into AUD will affect demand for the dollar. The level of Australian interest rates relative to overseas interest rates as well as the level of confidence in the Australian economy will affect the level of capital inflow. If Australia has relatively higher interest rates and stronger confidence, then this will encourage capital inflow and increase demand for the AUD. Using this theory, the Australian dollar at the present looks to be in a relatively strong position. Interest rates are beginning to rise (official interest rate has recently been risen 0. 25 points to 4. 5% and is expected to raise to 5.

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25% by September this year, with economic growth expected to be around 3.75% in 2002/03.) Also increasing the confidence in future economic growth is the recent budget. The 2002/03 budget released on 14th May 2002 was a deficit budget. This means that the government has spent more than it has earned. This is an injection of money into the Australian economy and will stimulate economic activity and growth. Price Expectations Expectations of a future appreciation of the AUD will increase the demand for the AUD by speculators as they expect to make a profit from buying the dollar now and selling at a later date at a higher price.

The Demand for Australian Exports The demand for Australian exports varies for a variety of reasons. One reason is changes in commodity prices. Another is the terms of trade. These two variations tend to have an immediate