It the supply curve should be steeper than

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It can be argued that under competitive conditions, demand for home currency in the foreign exchange market is inversely related to the variation in its exchange rate, resulting in a negatively sloped demand curve for it. The explanation for this stand lies in the fact that when the currency of home country depreciates, prices of its exports decrease while those of its imports increase. This adds to the demand for home currency in the foreign exchange market. In contrast, for corresponding reasons, the supply or offer of home currency in the foreign exchange market declines, so that its supply curve is positively sloped. i. Stability of equilibrium of exchange rate is ensured if the demand curve for home currency is negatively sloped, while its supply curve is positively sloped, and demand curve lies below the supply curve after its intersection with the supply curve.

ii. If the supply curve is also negatively sloped, the slope of the supply curve should be steeper than that of the demand curve, so that it lies below the demand curve after its intersection with the latter. The exchange rate equilibrium will be unstable, if both demand and supply curves of home currency are negatively sloped and the slope of the demand curve is steeper than that of the supply curve, so that it lies below the supply curve after its point of intersection with the latter. Impact on BOP Adjustment: Stability of exchange rate has an important and direct bearing upon BOP adjustment. The basic conclusion is that other things being equal, a stable rate of exchange automatically rectifies a deficit (or surplus) BOP, while an unstable rate of exchange worsens the deficit (or surplus, as the case be).

The supporting reasoning for this conclusion is that when BOP is in deficit, home currency depreciates so that exports of home country become cheaper

to the foreign country, and its imports become costlier for the domestic buyers. Consequently, the exports of the home country increase while its imports decrease till BOP deficit is wiped out. Just the opposite happens when the BOP of home country is in surplus and its currency appreciates.