Exchange Rate M - R & U - Reason-Based Quest

Q.1. Exchange rate expresses the ratio of commodity prices.

Ans. False. Exchange rate expresses the rate at which one currency exchanges for the other.

Q.2. Fixed exchange rate is determined by the market forces.

Ans. False. Fixed exchange rate is not determined by the market forces. It is determined by the government of the country.

Q.3. Float rate of exchange refers to flexible rate of exchange.

Ans. True. Float rate of exchange refers to flexible rate of exchange as it is determined by the demand and supply forces of foreign exchange in the international money market.

Q.4. In a situation of excess demand, equilibrium exchange rate is automatically restored.

Ans. True. The free play of forces of supply and demand operate in such a manner that the excess demand is automatically eliminated and equilibrium exchange rate is automatically restored.

Q.5. Decrease in demand for foreign currency leads to currency depreciation.

Ans. False. Decrease in demand for foreign currency leads to currency appreciation. Because, decrease in demand causes a fall in exchange rate.

Q.6. In case of currency appreciation, less rupees are to be paid to buy one US dollar.

Ans. True. In case of currency appreciation, less rupees are to be paid to buy one US dollar. Because, domestic currency (rupee) gains its value in relation to US dollar.

Q.7. When in order to buy 1 US dollar ₹ 75 are needed instead of ₹ 70 earlier, domestic currency shows appreciation.

Ans. False. Here, domestic currency shows depreciation because more rupees are to be paid to buy one US dollar. Depreciation of the domestic currency implies a fall in the value of domestic currency in relation to a foreign currency.

Q.8. Export of goods and services from India to US would mean outflow of foreign exchange to India.

Ans. False. Export of goods and services from India to US would mean supply (inflow) of foreign exchange to India. Therefore, foreign exchange in terms of receipts for exports flows from US to India.

Q.9. Supply of foreign exchange is positively related to the price of foreign exchange.

Ans. True. In the international money market, supply extends when the rate of exchange rises, and it contracts when the rate of exchange falls as indicated by an upward sloping supply curve of foreign exchange.

Q.10. Appreciation of foreign currency induces lower foreign direct investment from rest of the world.

Ans. False. Appreciation of foreign currency induces greater foreign direct investment from rest of the world. Because, now one unit of the foreign currency exchanges for more units of the domestic currency.

Q.11. In order to restore the value of depreciating domestic currency, central bank buys the US dollars in the international money market.

Ans. False. In order to restore the value of depreciating domestic currency, central bank sells the US dollars in the international money market. By selling the dollars, the bank expects to increase the supply of dollars in the market. Other things remaining constant, increase in supply is expected to reduce the price of dollar in relation to the domestic currency.