CLASS 9

TOPIC	***Foreign Exchange Policy***
LEARNING CONTENT - DETAILED CHARACTERISTICS	We present the foreign exchange market and the Balance of payments relationship. The foreign exchange market is a wholesale market where only financial intermediaries, large corporations, and central banks intervene. The relevant instrument to identify supply and demand for foreign currency is the Balance of payments, which describes all transactions with the rest of the world. Students become familiar with nominal and real exchange rates and the terms to express their changes. Different measures of exchange rates are presented. The concept of exchange rate policy is described considering the long run and the short run. In the long run we present the purchasing power parity and the Balassa-Samuelson effect, while in the short run we follow the relationship between real exchange rates and the trade balance based on the Marshall-Lerner condition and the J-curve. The process of how exchange rates can close external balance is discussed. Some instruments of exchange rate policies are presented. We take note that governments can affect the exchange rate through conventional and unconventional monetary policies, foreign exchange interventions, and communication policies. We present the intervention toolkit regarding the monetary channel, the portfolio channel, and the signaling channel.
KEY WORDS	Foreign exchange market, Balance of payments, current account, capital account, financial account, capital inflows, capital outflows, foreign direct investment, portfolio investment, foreign exchange reserves, nominal exchange rate, real exchange rate, appreciation, depreciation, law of one price, price-specie flow mechanism, absolute purchasing parity, relative purchasing parity, Balassa-Samuelson effect, Marshall-Lerner condition, J-curve, interest parity conditions, monetary channel, portfolio channel, signaling channel.
SUGGESTED TOOLS	Power-point presentation Critical thinking and analysis Real-world personal observation Interactive and group discussions A personal study plan
TIPS / METHODOLOGICAL REMARKS	Learning-by-doing and case studies activities. The focus is on the concept of exchange rate policy and the intervention toolkit the policymakers can apply.

(if applicable)		
IMPLEMENTATION OF THE CLASSES	**STEP 1**	Key terms and concepts are presented: foreign exchange market, Balance of payments and its components, exchange rates and their classification. The students know how to measure exchange rates.
	STEP 2	We present several ways to determine the exchange rate that show what factors can affect it and how policymakers can direct them. Considering the long run, we explain the law of one price, price-specie flow mechanism of David Hume, absolute purchasing parity, and relative purchasing parity. The Balassa-Samuelson effect is presented – intuitively and analytically. See work card 1.
	STEP 3	In the short run the exchange rate is determined by the relative price of goods and services in the domestic economy and abroad. In the medium term the Marshall-Lerner condition is generally met and the shape of the trade balance following an exchange rate depreciation is J-shaped. Some other theories are briefly presented. See work card 2.
	STEP 4	We present the instruments of exchange rate policies and study the link between monetary policy and the exchange rate through the interest parity conditions. The obstacles to capital inflows or investment abroad are one of the policies channels the government can use. So, a comprehensive framework to analyze the various mechanisms is needed.
	STEP 5	We present the ways the exchange rate is managed through conventional and unconventional monetary policies, foreign exchange interventions, and communication policies. We present the intervention toolkit regarding the monetary channel, the portfolio channel, and the signaling channel.

Crocodile Cross-disciplinary Academic Offer

Co-funded by the European Union

ADITIONAL MATERIAL 1 (WORK CARD, PICTURE, RECORDING, QUIZZ, PRESENTATION, ASSIGNEMENTS)

WORK CARD 1 – EXCHANGE RATE POLICY

Watch the video about the economist Bela Balassa:
https://www.youtube.com/watch?v=VvZy8wsIz_s

Bela Balassa

What strands does Bela Balassa work on and how do they relate to the Balassa-Samuelsson effect? How does the historical context relate to the derivation of economic theories? Why does Bela Balassa's research find application in the field of exchange rate policy?

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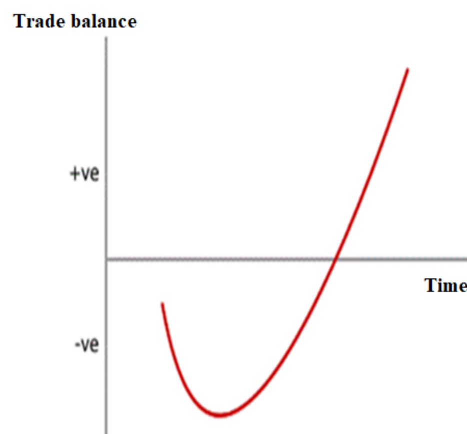
ADITIONAL MATERIAL 2 (WORK CARD, PICTURE, RECORDING, QUIZZ, PRESENTATION, ASSIGNEMENTS)

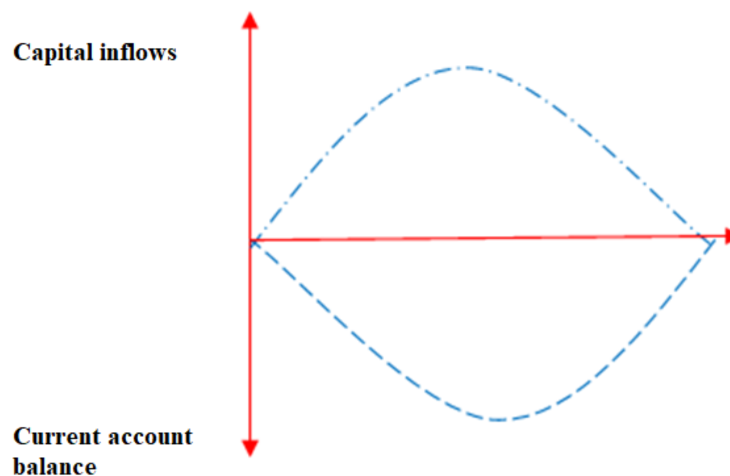
WORK CARD 2 – EXCHANGE RATE POLICY

Answer the following questions considering the figures below them:

1) What is the Marshall-Lerner condition? When and under what conditions does the J curve effect occur?



2) Comment on the relationship between the current account balance of the balance of payments and capital inflows or outflows to the country? What economic logic is observed in this relationship?



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