

Foreign Exchange Markets

Foreign Exchange Markets - Equilibrium prices in these markets are called exchange rates. These are rates at which a currency of one nation can be exchanged for the currency of another country.

If the dollar price of a foreign currency rises, the dollar buys less of the foreign currency than before. The dollar has depreciated relative to the foreign currency.

Depreciation of the dollar makes foreign goods expensive to U.S. so U.S. reduces imports.
Depreciation of the dollar reduces the price of U.S. goods to foreigners so U.S. exports rise.

If the dollar price of a foreign currency falls, the dollar buys more of a foreign currency than before. The dollar has appreciated relative to the foreign currency.

Appreciation of the dollar makes foreign goods cheaper to U.S. so U.S. increases imports.
Appreciation of the dollar increases the price of U.S. goods to foreigners so U.S. exports fall.