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COURSE TITLE: INTERNATIONAL ECONOMICS 2

**ASSIGNMENT**

1. a. Foreign Exchange management is the core issue in international finance . Discuss.

b. How does this affect the Balance of Payment of your home country.

1. Explicitly show the issues in FEM using your home country as case study.

Answer

1a

Exchange rates are very important in international finance, as they let us determine the relative values of currencies. International finance helps in calculating these rates. By relative value we mean the worth of one countries currency in relation to another.

b. A change in a Nigeria’s [balance of payments](https://www.investopedia.com/insights/what-is-the-balance-of-payments/) can cause fluctuations in the [exchange rate](https://www.investopedia.com/terms/e/exchangerate.asp) between its currency and foreign currencies. The reverse is also true when a fluctuation in relative currency strength can alter the [balance of payments](https://www.investopedia.com/terms/b/bop.asp). There are two different and interrelated markets at work: the market for all financial transactions on the international market (balance of payments) and the [supply and demand](https://www.investopedia.com/articles/economics/11/intro-supply-demand.asp) for a specific currency (exchange rate).

These conditions only exist under a free or [floating exchange rate](https://www.investopedia.com/terms/f/floatingexchangerate.asp) regime. The balance of payments does not impact the exchange rate in a fixed-rate system because [central banks](https://www.investopedia.com/terms/c/centralbank.asp) adjust currency flows to offset the international exchange of funds.

The world has not operated under any single rules-based or fixed exchange-rate system since the end of [Bretton Woods](https://www.investopedia.com/terms/b/brettonwoodsagreement.asp) in the 1970s.

To explain further, suppose a consumer in France wants to purchase goods from a Nigerian company. The Nigerian company is not likely to accept euros as payment; it wants Naira . Somehow the French consumer needs to purchase Naira (ostensibly by selling euros in the forex market) and exchange them for the Nigerian product. Today, most of these exchanges are automated through an intermediary so that the individual consumer doesn't have to enter the [forex market](https://www.investopedia.com/terms/forex/f/forex-market.asp) to make an online purchase. After the trade is made, it is recorded in the [current account](https://www.investopedia.com/terms/c/currentaccount.asp) portion of the balance of payments.

The same holds true for [investments](https://www.investopedia.com/terms/i/investment.asp), [loans](https://www.investopedia.com/terms/l/loan.asp), or other [capital flows](https://www.investopedia.com/terms/c/capital-flows.asp). Nigerian companies normally do not want foreign currencies to finance their operations, thus their expectation for foreign investors to send them Naira. In this scenario, capital flows between countries show up in the [capital account](https://www.investopedia.com/terms/c/capitalaccount.asp) portion of the balance of payments.

As more Naira are demanded to satisfy the needs of [foreign investors](https://www.investopedia.com/terms/f/foreign-investment.asp) or consumers, upward pressure is placed on the price of Naira. Put another way: it costs relatively more to exchange for Naira, in terms of foreign currencies.

The exchange rate for Naira may not rise if other factors are concurrently pushing down the value of Naira. For example, expansionary [monetary policy](https://www.investopedia.com/articles/investing/050615/fiscal-vs-monetary-policy-pros-cons.asp) might increase the supply of Naira.

2.

The primary objective of foreign exchange management is to reduce foreign exchange instability and its adverse effect on the economy. Despite government efforts to achieve this objective through the central bank of Nigeria (CBN), foreign exchange (monitoring and miscellaneous provisions) Decree No promulgated in 1995 and the introduction of the use of forms  A and 19 in 1996, a handful of problems are still identified with foreign exchange operations in Nigeria.  These problems include

(i)    Inadequate inflow of foreign exchange

(ii)   Continuous depreciation in the value of the Naira

(iii)   Balance of payment problems

(iv)   Problem of finding Sectorial allocation of foreign exchange in the foreign exchange market