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ECO 314: INTERNATIONAL ECONOMICS

ASSIGNMENT

1. Foreign exchange is essential to coordinate global business. Foreign exchange management is associated with currency transactions designed to meet and receive overseas payments. Beyond these transactions, foreign exchange management requires you to understand the relevant factors that influence currency values. From that point, you may execute the proper strategy to manage risks and improve potential earnings. Foreign exchange management begins with trading currencies to exchange goods and services overseas. International businesses convert overseas profits back into their domestic currency to spend at home. Meanwhile, consumers exchange domestic currency for foreign banknotes to buy overseas goods. These transactions occur within the foreign exchange markets, where networks of private individuals, banks and organized financial exchanges provide the infrastructure to trade international banknotes.

As you know, money is anything that is accepted as a medium of exchange. In most of the world, people accept pieces of paper imprinted with pictures of national heroes or local wonders of nature as money. But in each nation, they accept different pieces of paper.

This means that if someone in the United States wants to buy something from someone in, say, Mexico, she must first exchange her local currency—dollars—for the currency accepted in Mexico—pesos. This currency conversion occurs at an exchange rate. The exchange rate—the price of one nation's currency in terms of another nation's—is a central concept in international finance. Virtually any nation's currency can be converted into the currency of any other nation, thanks to exchange rates and the foreign exchange market. For instance, let's say the current exchange rate between the U.S. dollar and the Mexican peso is $1 to 10 pesos. This means that $1 will buy 10 pesos and that 10 pesos will buy $1.

Types of Exchange Rates

* Fixed rates
* Floating (or flexible) rates
* Managed rates

With a fixed exchange rate, the value of the currency is determined by the nation's central bank and held in place by central bank actions, mainly the purchase and sale of the currency. Another way to fix exchange rates, which has been used by the United States and other nations in the past, is to tie currencies to the gold standard. If all the currencies in the exchange rate system have a value pegged to gold, it is a simple matter to convert the currencies to one another according to their value in gold.

Floating exchange rates are determined by the market forces of supply and demand. We will examine these forces in this section. Essentially, if demand for a currency increases, the value of that currency in terms of other currencies increases. If demand for the currency decreases, then the value of the currency decreases.

Managed exchange rates are influenced by nations' central banks, but are not targeted to a fixed rate. In practice, the system of managed rates that we have today operates through the forces of supply and demand *and* are influenced by central banks. So we now have a mix of floating and managed rates, which is called managed float.

So why Foreign exchange management is the core issue in international finance is because of the inconsistent rates which different currencies are exchanged at. If there is a steady exchange rate which the international market can be using then the problems that the international market faced today will be half solved.

b) It affects the Balance of payment of the country’s economic growth due to the desire to generate foreign exchange and reiterate the function of demand as the motivation for domestic growth. This arises because growth in export and investment growth in import substitution are the only aspect of aggregate demand that can increase GDP growth and reduce foreign constraint. This implies that growth rate is constrained by the balance of payment as the economy cannot grow faster than what is consistent with the balance of payment equilibrium.

1. 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:
2. Inadequate inflow of foreign exchange
3. Continuous depreciation in the value of the Naira
4. Balance of payment problems
5. Problem of finding sectorial allocation of foreign exchange in the foreign exchange market.