Determination of Exchange Rate :

The exchange rate among different currencies is determined in the foreign exchange market. The foreign exchange market is the market in which the currencies of various country are converted or exchange for each other.

Demand For Foreign Exchange (US Dollar) :-

The demand for US dollar comes from the Indian people who need the US dollar to pay for the goods and services they part of import from the USA. The greater the import of goods and services from the USA, the greater the demand for the US dollar by the indians. Further, the demand for dollar also arises from individuals and firms wanting to purchase assets in the USA, i.e desire to invest in shars of America companies. The demand for dollar also arises from those who wants to give loan or send gift to people in the USA.

Condition: When dollar depriciate

eg: 1 dollar = Rs.45
1 dollar = Rs.44

→ Fewer rupees than before would be required to get a dollar.
→ US goods becomes cheaper → imports ↑ → demand for dollar ↑

If, dollar appriciate

eg, 1 dollar = Rs.44
1 dollar = Rs. 45

→ US goods becomes costly → imports ↓ → demand for dollar ↓

Explain When there is a fall in the price of dollar in terms of rupees i.e when dollar depriciate, fewer rupees than before would be required to get a dollar. The US goods would becomes cheaper, this will induce the individual and firm to import more from the USA. It results in the increase in quantity demanded of dollar by the Indians. Again if US dollar appriciate, US goods become costly in terms of rupees. This will discourage the import of US goods causing a decrease in quantity demanded of a dollars.

Supply of Foreign Exchange (US Dollar):

The individual firm export indian goods to the USA. will earn dollar to buy Indian goods and pay their prices in dollar. Further the Americans who travel in India will also supply dollar to be converted into rupees. Besides the american firms and individual who wants to buy assets in Indian and wish to make loans to the Indian individual will also supply dollars.

Conditions

When Indian Rupees depriciates;

1 dollar = Rs. 45

1 dollar = Rs. 46

→ Indian goods become relatively cheaper → export ↑ → supply of dollar ↑ and vice versa.

Explain

The supply curve of dollar plotted against the prices of dollar in terms of rupees in positively sloping. At a lower value of Indian rupees in terms of dollar i.e when the value of rupees depriciatios Indian goods would be relatively cheaper this will tend to boost exports of the Indian goods to the USA and thus more supply of dollar in the foreign exchange market. On the other hand, at higher values of the Indian rupees in terms of dollar i.e. if the price of dollar in terms of rupees falls, the indian goods would become relatively expensive in terms of dollar. This will discourage the exports of Indian goods to the USA and reduce the quantity supplied of dollar in the foreign exchange market.