10. **Why under flexible exchange rates does a nation not have too worry too much about a balance of payments deficit? What other specific advantages do flexible exchange rates give to the operation of economic policy with specific regard to the effectiveness of fiscal policy and monetary policy?**

A: exchange rate – for economic exchange with the rest of the world. What will happen to demand of AUD to buy Australian products (exports)? What will happen to supply of AUD to buy foreign products (imports).

When exchange rate is flexible – if Australian export increase, the demand for AUD will increase as a result AUD will appreciate.

What will happen to balance of payment.

Effects of exchange rates in current assets – balance of trade (export – import) and interest on investment.

Effects of exchange rates in financial a/c – flow of capital (inflow-outlfow)

official reserves – used to keep exchange rate at a certain level.

balance of payment surplus = (export – import) + (capital inflow – capital outflow) > 0

balance of payment deficit = (export – import) + (capital inflow – capital outflow) < 0