Microeconomic

[Economics](), [Microeconomics]()

What has been happening to the exchange rate of the US$? Give reasons. How is the exchange rate of a currency determined? If the value goes down will that help or hurt the trade deficit?

This year, the US dollar continued its long-expected slide. The Economic Intelligence Unit (2007) reported that the dollar had shown substantial resilience in recent months, even though investors were convinced that the Federal Reserve would not raise short-term interest rates again during this cycle. But interest rate and growth differentials are moving strongly against the dollar and investors are again shifting their attention to the US's massive external deficits.

This will result in the dollar losing further value, averaging US$1. 36: €1 and Y105: US$1 in 2007. We then expect a moderate and gradual recovery of the dollar against the euro as the US economy emerges from its weakness in 2007. Nevertheless, room for appreciation will be limited by the current-account deficit, the share of GDP of which will be reduced only gradually. The dollar should continue to weaken against the yen in 2008.

As an exchange rate is the rate at which one country's currency can be traded for another country's currency, the U. S. exchange rate is influenced country's income, a country's prices, the interest rate in a country, and the country's trade policy. That means that changes in a country's income, changes in a country's prices, changes in interest rates, and changes in trade policy can cause the supply of and demand for a currency to shift (Colander 2004).

If the exchange rate of the dollar continues to go down, it will definitely help to diminish the trade deficit. This means the United States' demand for imports will be lowered and foreign countries' demand for U. S. exports will become higher because of the low dollar exchange rate. After years of having large trade deficits, the US now experienced a lowered exchange rate because a trade deficit often leads to a global excess supply of that country's currency. With everything else equal, the exchange rate should undergo pressure to depreciate because of this excess supply; with freely floating rates, it can do so. Then the exchange rate change passes through to affect the relative prices of imports and exports.

2. What has been happening to the price of oil on international markets? Discuss the different impacts that this has on the economy, the producers, consumers, pollution, alternative fuels etc.

Oil price increases over the past years have been an issue is closely watched and debated because of its huge impacts around the world. For example, a report by the International Energy Agency (May 2004) deemed that " higher oil prices since 1999 – partly the result of OPEC supply-management policies – contributed to the global economic downturn in 2000-2001". Another result of which is that " current cyclical upturn" lagged behind because the " world GDP growth may have been at least half a percentage point higher in the last two or three years had prices remained at mid-2001 levels".

The IEA report (May 2004) pointed out that " higher prices are contributing to stubbornly high levels of unemployment and exacerbating budget-deficit problems in many… oil-importing countries". It furthered that the continued increase in oil prices will be deadlier to developing countries because " their economies are more dependent on imported oil and more energy-intensive and because energy is used less efficiently”. The report informed that “ oil-importing developing countries use more than twice as much oil to produce a unit of economic output” and when oil prices are high, their efforts in development will surely be affected.

However, in the closer analysis, higher oil prices could do more good than bad in the world economy. The Economist Intelligence Unit ViewsWire (May 2006) deemed that although higher oil prices directly worsen a developing country’s trade balance and its current-account deficit that could also reduce corporate profitability and disposable income”, this reduction in domestic demand (the painful part), combined with a depreciation in the exchange rate, should be helpful in boosting exports and cut imports. In the end, higher oil prices are helping restore a country's current-account to its previous position. This is the reason why some developing countries in Asia have been hardly hit by higher oil prices in the recent years.

With continued oil price increases, it will also lessen pollution because people will naturally look for alternative fuels which will be more environmentally-friendly. This will distribute the income from alternative fuels and oil-producing countries, which will eventually stabilize in the future, if the demand for oil will become lower. Car manufacturers will also try their hand in making their products more efficient with the use of fuel. All these improvements will serve up to the benefit of everyone, whether oil exporting or importing countries, because the oil resources are not limitless and should be conserved for the future generation.

3. How equally is income distributed in the US? What are the reasons? Should the government interfere? If so how and what would be the consequences? How important is social pressure in CEO pay?

Income distribution in the United States has a wide disparity. This means that, in 2000, the top 5 percent highest income earners has incomes 19 times higher than the incomes of the bottom 20 percent (Bernstein, 2003). Moreover, according to Swann (2005), the average personal income fell by 0. 1 percent in August 2005, depressed by weak wage growth and the effects of hurricane Katrina on income in the affected states. Wages rose by just 0. 2 per cent - failing to keep pace with a 0. 5 per cent rise in prices. Meanwhile the savings rate remained in negative territory, but improved slightly from - 1. 1 per cent to -0. 7 per cent.

However, a recent study entitled " Changes in the Economic Resources of Low- Income Households with Children" conducted by the Congressional Budget Office (CBO) reported that from 1991 to 2005 an average household incomes among families that had children under age 18, the average household income for the lowest quintile of families with children increased from $12, 400 in 1991 to $16, 800 in 2005. These figures reflect inflation-adjusted dollars and are expressed in 2005 purchasing power. That 14-year change represented a total real increase of 35. 5 percent, which reflects a yearly average of 2. 2 percent (Washington Times, 10 June 2007).

The government should interfere if there is a wide income gap because the general public will exhibit perplexity and annoyance to the growing pay gap between CEOs and other workers. However, organized resistance has been largely confined to groups with direct financial interests, such as pension funds. When the business community has deemed it necessary to justify executive pay, it has couched explanations in terms of contributions to shareholder profits rather than involving itself in income disparity issues. Its stance has been that if the public could only be helped to understand the role of the executives in enhancing the wealth of the corporation, controversy would evaporate.

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