Factors influencing exchange rates economics essay

“ The exchange rate is the most important price in any economy, for it affects all other prices. In most countries, policy toward the national currency is prominent and controversial. Economy epochs are often characterised by the prevailing exchange rate system” (Gold standard era, the Breton wood era). In other words exchange rate is show the amount of rate which you are comparing with other currency. It shows the value of currencies between two countries and define how much one currency worth to other.

THERE ARE SOME FACTORS WHICH INFLUENCED EXCHANGE RATE:

INFLATION RATE:

Changes in relative inflation rates can affect international trade activity and which influence the demand for and supply of currencies and therefore influences exchange rate. For example, if India inflation higher than the UK and the UK inflation is constant. This sudden increase in India inflation should reason for growth in India demand for British product and in India also increase the pound demand because India will do more import to UK. This situation increases the demand of the pound in the market because India supply pound for import. In addition, the increase in India inflation reduces the UK desire for Indian goods and therefore reduces the supply of pound for sale.

INTEREST RATE:

When a country changes its interest rate it’s attempting to influence the overall level of expenditure in the economy. The interest rate influences the exchange rate because it influences the demand and supply of currencies on the foreign exchange market. For example, if in India interest rate is 5% and in UK it is 3% than there is may be advantages for India because in India rupees will be transfer as security. In this situation demand of rupees would high and supply of pound will also rise. This would put pressure on the price of rupees and puts its value up against the pound.

CHANGE IN COMPITITIVENESS:

If the Indian goods become more popular and attractive compare to UK's product. This will also raise the investment of pounds in the India and increase the demand of Indian products in the market. It will help India to improve in its economy because supply of Indian product would increase the competitive markets between the some countries to invest in India. This also helps India to make effective value of rupees in the market.

BALENCE OF PAYMENT:

A currency appreciation achieved by lowering prices reduces the demand for monetary balances, genets an excess supply of money and leads to a transitory balance of payment deficit as residence seek to restore monitory equilibrium through the international credit and commodity market. Balance of payment means account value of import greater than export. For example, if India doing export more than import than the value of currency would increase and it also increase the exchange rate because with export India received lots of other currency , Which help India to supply in rupees. On the other the low import make low surplus which also affect the exchange rate in demand and supply. The balance of payments represents an instrument important in explaining the evolution of the exchange rate and it is also an instrument important in predicting the evolution of the exchange rate.

RELATIVE STRENGHT OF OTHER CURRENCIES:

If currency rate of India is higher than UK than the demand of Indian rupees would increase in the market and this demand of Indian rupees increase the value of the currency. If Indian currency is week compare with other countries it shows the value of the rupees would decrease because others countries will not invest their security in it and this situation decrease the supply of rupees in the market. This situation is another reason of influence of exchange rate.

INCOME:

SPECULATION:

Speculator, who takes the currencies in advance just because of production of rate, would be increase. Speculators earn money as profit of currency. They take large amount of money from the market and increase the demand of the currency and supply currency after add their profits so this situation rise the demand of currency and this shortage of money in the market is also reason for influence in exchange rate.

BENEFIT OF WEEK CURRENCIES:

GREATER EMPLOYMENT IN EXPORT INDUSTRIES:

When a country has week currency that time it has lots of profit in the market because in this situation foreign buyers attracts and invest in this country. In this situation every country would expect benefit from its investment and it increases the export market of the country. Increment in the export promotes the greater employment because large investment creates large demand and increase in employment rate.

TOURISM:

Tourism represents a big part of the country economy. It supports employment for workers and increase annual revenue. For example, if the American dollar is weak compared to the euro, and then Europeans will find that it is very cheap for them to travel to the United States. So tourist would attract to United States because of their week dollar. More tourism is always good for an economy.

Foreign Investment:

There are many ways that foreign investors are investing in those countries that has week currency. It is the best option for investor because they are investing in low currency rate in the market but they will receive a good profit after the investment. For example, According to a study by the National Association of Realtors, about one in five American real estate agents sold a second home in the year ending April 2007 to a foreign buyer. A third of these buyers come from Europe, a quarter from Asia and 16 percent from Latin America. As the US dollar is week in the market. This situation shows the week currency attracts to investors and help to country to grow in the market.

CONCLUSION: