How Exchange Rate Influence a Country's Import and Export

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Abstract- Businesspersons and governments all over the globe are very serious about the severe results of currency appreciation and depreciation on different things such as imports, exports, domestic products, etc. Academic researchers conducted many researches in order to explore the impact of currency fluctuations on the import and export of the country as well. Many researchers concluded that G-7 countries exports and imports took the effect due to currency fluctuations during the period of 1982-1997. Depreciation in exchange rate increases the domestic currency value and decreases the value of our own currency as well. If our own country currency rate increases due to foreign exchange rate declines then the domestic country can import the goods at cheap prices. In contrast if the home country currency decreases due to an increase in exchange rate then the imports of the home country will decreases due to increasing in other country prices as well. If the domestic currency appreciates due to declining in exchange rate the domestic country exports will bring the high foreign exchange for the country and vice versa. When some countries currency increases or decreases, it brings the changes in the whole business of the country at very much extent (Kandil, Berument, & Dincer, 2007)).

Introduction

Businesspersons and governments all over the globe are very serious about the severe results of currency appreciation and depreciation on different things such as imports, exports, domestic products, etc. Academic researchers conducted many researches in order to explore the impact of currency fluctuations on the import and export of the country as well. Many researchers concluded that G-7 countries exports and imports took the effect due to currency fluctuations during the period of 1982-1997. Depreciation in exchange rate increases the domestic currency value and decreases the value of our own currency as well.

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It is an ongoing debate especially in developing countries. The fluctuations level may take the effect of country internal and external shocks in financial of other trading partners. It has been discussed that due to globalization evolution the one country financial brings the change in the other financial structure also. The reason is that the countries are interlinked now days. They have

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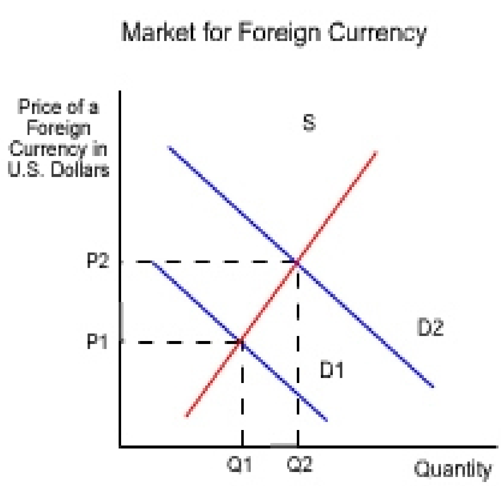
become a global partner in trade. The imports and exports are also because the currency of one importing and other exporting country was exchange when transaction took place.

Exchange rate is a rate at which currencies are exchanged between countries. It's also known as the value of one countries' currency in terms of other countries' currency. For example, an interbank exchange rate of 91 Japanese yen (JPY, ¥) to the United State dollar (US$) means that ¥91 will be exchanged for each US$1 or that US$1 will be exchanged for each ¥91.

Effect of Exchange rate on Exports and Imports of a Country:

- Exchange rates can be manipulated so that they deviate from their natural equilibrium rate. To stimulate exports, rates would be held down, and to reduce inflationary pressure rates would be kept up. The Monetary Policy Committee (MPC) w i l l t a k e



exchange rates into account. In the free market Imports and exports determine and affect the exchange rate though governments and financial institutions in their audacity feel they control it. In the same way that supply and demand for products shift to change the prices of those products, the constant shifts in the supply and demand for foreign currency result in changing prices of currency. As a result, the "price" of money changes as demand for foreign currencies changes. This "price" of foreign currency, in terms of U.S. currency, is known as the foreign exchange rate.

- **Exporting goods and Importing raw material:**

If the exchange rate falls, this changes the relative prices of imports and exports. Exports will appear to become relatively cheaper in other currencies, and imports will appear to be more expensive. Because we buy imports, they are included as part of the retail price index, and so if the price of imports goes up, this could be inflationary.

The effects on aggregate demand may compound this inflationary impact. Since exports are relatively cheaper overseas, this should increase the demand for them. In addition the demand for imports should fall. The combination of the two will have a positive impact on aggregate demand because net exports is one of the components of the AD function (AD= C+I+G+(X-M) How much the demand increases depends on the price elasticity of demand for exports,

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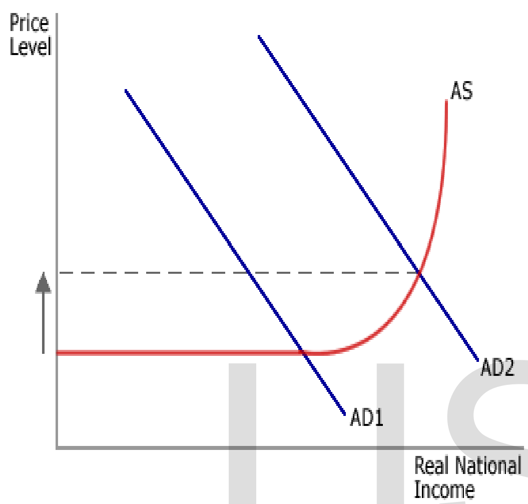
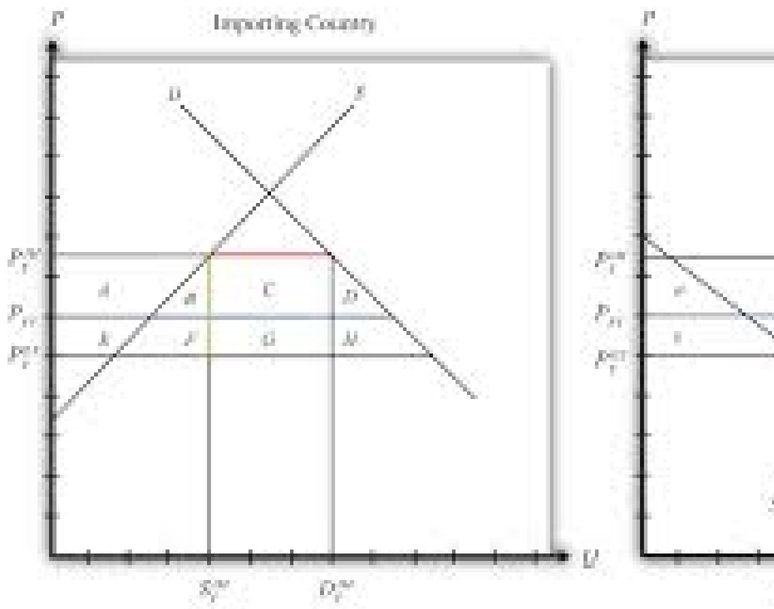
but the demand should certainly grow. Growth in aggregate demand could also be inflationary if the economy is close to its capacity. On the diagram below you can see the shift in aggregate demand (AD1 to AD2) pulling up the price level (demand-pull inflation).



Impact on importers of raw material:

Exchange rate affects value of imports of a country directly, if a person is importing raw material from any other country to make finished goods. If the exchange rate of the country is at a lower side then its importers have to pay high price of raw material purchased because the value of their currency is low in the other country, and vice versa



Impact of appreciation on business:

It cannot be denied from the fact that economies take the effect of fluctuations in the foreign exchange rate of a domestic country or its trading partners as well. When economies of countries take the effect, this effect is diversify on almost all businesses of the country. When countries exchange rate increases the import of that countries went toward decrement. If the countries exchange rate decreases the import of that countries increases. If some countries exchange rate increases the exports of those countries, decreases and companies earn more against their export. If the exchange rate of that country decreases, the exports of that country will also increases. What is the logic behind this system? A great chain is working behind this system. When domestic country currency appreciates the people, of that country purchasing power, increases, and they demand more luxury

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products due to which county overall business takes the effect of it, and, imports increased.

If the domestic country currency depreciates, the individuals of that country do not have much money, and inflation has increased due to which the prices of the domestic goods increased. Along with the increment in prices of the domestic products increases because the imports have been stopped by the businesspersons and the demand of domestic products also has been increased. Therefore, we can say that the increases in currency rate results a decrease in the import of that country (Dausa, 2009)

When imports level went down the business, become worry because almost everywhere the imported products are necessary in order run the industry of the domestic country. For example, if our country imports the cotton from china and the currency rate has increased due to which our industry that raw material is cotton will not continue its businesses smoothly. On the other hand if the currency rate of our country will decrease the imports of our country will increases and our business community will run their businesses smoothly. If one country exchange rate increases the exports of this country will go down because the imports have been, go down.

The prices of the raw material for products have been increased because in our own country demand for that product has been decreased as well. One more thing that is too important and considerable is that the businesses takes the effects and spread it in all over the country because businesses are linked with other institutions in order to run it smoothly. These businesses such as the textile mill is linked with importers, suppliers, financial institution, governments and other human capital these all are interlinked due to which the change in one component affects the other partner. It might be possible that the effect may be small or long. Therefore, the end it can be said that the depreciation of the country at any level is bad for the country business persons, governments, economy and even very small segment of population (Heim, 2009).

The one more important thing is also notable that the currency depreciation may lead down the aggregate demand of that country. The supply side channels become more difficult when the currency depreciation took place at very large level. All the factors are affected because the currency of the country is the main source of exchange. In the end, it can be concluded that depreciation of the country increases exports but along with that cost of exported products increases accordingly while currency appreciation decreases the exports, and the cost of production also decreases accordingly. The demand and supply channels finalize the exchange rate results such as output and prices of the products.

Evaluation of the changes within the exchange rate on business:

- Elasticity. The impact of an appreciation depends upon the price elasticity of demand for exports and imports.
- The impact of an appreciation depends on the situation of the economy. If the economy is in a recession, then an appreciation will cause a significant fall in aggregate demand, and will probably contribute to higher unemployment. However, if the economy is in a boom, then an appreciation will help reduce inflationary pressures and limit the growth rate.
- It also depends on economic growth in other countries.
- It also depends why the exchange rate is increasing in value. If there is an appreciation because the economy is becoming more competitive, then the appreciation will not be causing a loss of competitiveness. But, if there is an appreciation because of speculation or weakness in other countries, then the appreciation could cause a bigger loss of competitiveness

- **Evaluation of the changes within the exchange rate on business:**

The exchange rate in a business plays an important role for the country, which export goods and import raw materials. Business strategies and movement entirely depends on the exchange rate of a country. In addition to its direct effects on the global trading and production structure, the ongoing process of globalization may have important implications for the interaction of exchange rates and the overall global economy.

Elaborating on the significance, the exchange rate expresses the national currency's quotation in respect to foreign ones. For example, if one US dollar is worth 10 000 Japanese Yen, then the exchange rate of dollar is 10 000 Yen. If something costs 30 000 Yen, it automatically costs 3 US dollars as a matter of accountancy.

The global floating exchange rate system operation forces the market demand and supply, determining the daily value of one currency against another. The system affect exchange rate on business, tend to go up in value when a country is running a large trade surplus and when overseas investors regard the currency as a good one to buy.

In determining the types of the exchange rate. It is customary to distinguish nominal exchange rates from real exchange rates. Nominal exchange rates are established on currency financial markets called "forex markets", which are similar to stock exchange markets. Rates are usually established in continuous quotation, with newspaper reporting daily quotation (as average or finishing quotation in the trade day on

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a specific market). Central bank may also fix the nominal exchange rate.

The regime includes when the exchange rate can freely move, assuming any value that private demand and supply jointly establish, "freely floating exchange rate" will be the name of currency institutional regime. Equivalently, it is called "flexible" exchange rate as well. If the central bank timely and significantly intervenes on the currency market, a "managed floating exchange rate regime" takes place. The central bank intervention can have an explicit target, for example in term of a band of currency acceptable values.

In "freely" and "managed" floating regimes, a loss in currency value is conventionally called "depreciation", whereas an increase of currency's international value will be called "appreciation". If the dollar rise from 10 000 yen to 12 000 yen, then it has shown an appreciation of 20%. Symmetrically, the yen has undergone 8.3% depreciation. But central banks can also declare a fixed exchange rate, offering to supply or buy any quantity of domestic or foreign currencies at that rate. In this case, one talks of a "fixed exchange rate".

Exchange rate on business directly effects on the global trading and production structure, the ongoing process of globalization may have important implications for the interaction of exchange rates and the overall economy. Change in the exchange rate influence of the economy can have powerful effects on the macro economy affecting variables such as the demand for exports and imports; real GDP growth, inflation, business profits and jobs. With most variables in economics, there are time lags involved. The impact of movements in currencies on the economy depends in part on whether the change in the currency is short-term or long-term. Further elaboration would mean to identify the change in the exchange rate temporary or likely to persist for some time? And how businesses and consumers respond to exchange rate fluctuations. Meaning will there be a large change in demand for exports and imports?

It is important to identify possible changes in the role of exchange rates in a more globalized economy. Analyses the link between exchange rates and prices, shows that there is a moderate decline in exchange rate pass-through for the euro area. Next, it turns to the effect of exchange rate changes on trade flows. In addition, the overall impact of exchange rates on GDP and the potential role of valuation effects as a transmission channel in the case of the euro area.

In Exchange rate the term, Appreciation makes exports more expensive and reduces the competitiveness of exporting firms. Depreciation makes exports cheaper and the exporting firms will be positively impacted by it. Exchange rate devaluation (or depreciation) gives rise to inflationary pressures: imported good become more expensive both to the

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direct consumer and to domestic producer using them for further processing. In reaction to inflation (actual and feared), the central bank can raise the interest rates, thus sending a recessionary impulse.

> Currency crisis have a sweeping impact on income distribution. The few rich are able to borrow (because they have collateral and the banks trust them) will get richer and the people purchasing imported goods facing inflation and reduction of real incomes. Symmetrically, the central bank may use a fixed exchange rate as a nominal anchor for the economy to keep inflation under control, compelling domestic producer to face tougher competition as soon as they decide to increase prices or accept to pay higher wages. For a small economy, joining a monetary union makes the exchange rate to fluctuate according to fundamentals and market pressures referring to a much larger area, erratically going in directions that are (or are not) coherent with positive macroeconomic developments. For statistics purposes, international comparisons of current values converted to a common currency are "distorted" by wide exchange rate fluctuations

Conclusion:

The exchange rate of the currency occupies a portfolio that holds the bulk of its investments, which determine the portfolio are real return. As supply and demand for currencies change, the values of those currencies change. When the U.S. dollar is strong, imports seem less expensive, leading to increased demand for imported products and the currency needed to purchase them. In addition, when interest rates in another nation are higher than those in the U.S., demand for the foreign currency rises, as people buy the currency in order to invest in the other nation's securities. A declining exchange rate obviously decreases the purchasing power of income and capital gains derived from any returns. Therefore, a trade deficit develops as the result of a strong dollar. The opposite effects result from a weak U.S. dollar. While importers prefer a strong dollar, exporters prefer a weak dollar.

Moreover, the exchange rate influences other income factors such as interest rates, inflation and even capital gains from domestic securities. While exchange rates are determined by numerous complex factors that often leave even the most experienced economists flummoxed, investors should still have some understanding of how currency values and exchange rates play an important role in the rate of return on their investments. Therefore, the effects of currency crises in other nations are not limited to those nations -- they can affect our economy and our lives in important ways.

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