Exchange rate changes: Macro factors

Instructions:

Have students consider how the objectives in the table might be affected by a sudden sharp drop in the £. Get them to do it individually using the printable resources and then feed back to small groups before getting the groups to feed back to the class as a whole using the digital resource.

Exchange rate changes: Macro factors:

Suppose the pound depreciates sharply against other leading world currencies. How might the key policy objectives be affected?

Objective	Impact?
Growth	
Unemployment	
Inflation	
Trade balance/current account	

Exchange rate changes: Macro factors

Possible answers:

Growth: In principle the weaker pound will make UK exports cheaper in terms of foreign currency and imports cheaper in sterling terms. Therefore there should be an increase in X and a fall in M, increasing AD and promoting short term growth. However, PED for both may be low in the short term, because of factors such as loyalty to suppliers and contracts, and export performance will depend on the nature of exports and export markets. Hence there is a risk that, especially in the short run, the value (in total) of imports may actually rise sharply, damaging growth.

Jobs: As noted in growth, in principle, exports should rise and firms competing with imports should also see an upturn in demand, but it depends on many factors as noted in growth. Import-dependent firms, for example may face job losses.

Inflation: There should be unequivocal upward pressure on inflation. The decrease in Px will increase demand in export sectors and the rise in Pm will create cost-push pressures elsewhere.

Trade balance. Should in principle improve in the longer run, but see the section on growth.