

A Study on Exchange Rate Movements in Different Regions

Lakavath Vijay Kumar

Economics PG Student University PG College, Subedari, Kakatiya University

Abstract:

The paper researches the wellsprings of genuine swapping scale developments in various districts by deteriorating genuine conversion scale developments into those owing to genuine and ostensible stuns. Considerable conversion standard developments have happened in a significant number of the created and creating nations in the course of recent decades. The results of real changes in return rates are of enthusiasm for two reasons, right off the bat since they may effectly affect global exchange (Baldwin and Krugman, 1989), and also in light of the fact that these impacts might be practically identical to the impacts of levy diminishments (Feenstra, 1989). Analyzing the impacts of trade rates on efficiency, Harris (2001) recommended that the deterioration of the dollar may have been a contributory factor to the broadening profitability hole between the numerous locales, since it might prompt the expanding expenses of imported apparatus and gear, extended the advancement hole, and backed off the procedure of imaginative decimation.

Keywords: exchange rate movements, Regions, tariff reductions

Introduction:

One aim of this book is to examine the causes of fluctuations in the different currencies real exchange rates for the period 2010-2015 with quarterly data to determine appropriate policy recommendations to reduce these movements. A second aim is to investigate whether the three real exchange rates are covariance-stationary or not

and to which extent they are covariance-stationary, respectively. These aims are reached by using a two-country overshooting model for real exchange rates with real government expenditure and by applying Johansen's maximum likelihood cointegration procedure and a factor model of Gonzalo and Granger to this model.

The Causes of Real Exchange rate movements

Increasing exchange rate fluctuations, such as those that have occurred in the US dollar, have recently revived the discussion about the causes of such movements and the criteria for calculating the long-term over- or undervaluation of a currency. This article stresses some aspects that have attracted little attention hitherto. Notions about the main factors influencing exchange rate developments are often coloured by the purchasing power parity theory, which states that the exchange rate of a country's currency is determined, at least over the long term, by differences in price trends between that country and the rest of the world. The theory rests on the assumption that domestic and foreign goods are highly interchangeable, so that if domestic prices rise while those abroad remain stable or increase less sharply, the difference will be offset by corresponding exchange rate changes as a result of international arbitrage in goods. Under a system of fixed exchange rates, this offsetting effect takes the form of price adjustments to changes in domestic and foreign demand. In a more diluted version of the theory, it is assumed that this "law of one price" applies only to the prices of internationally tradable goods, but that each country also produces goods that can only be traded nationally and are not directly subject to the price rule. If price differences develop, shifts in the

domestic demand for internationally tradable and non-tradable goods over time lead to price adjustments for these goods, too. 1 According to the purchasing power parity theory, the real exchange rate of a currency, that is to say the nominal exchange rate adjusted for differences in inflation rates, is therefore constant over the long term. In reality, however, the real exchange rates of the industrial countries' currencies vis-&-vis those of their main trading partners (i.e. their effective real rates) also show marked changes over very long periods that cannot be explained merely in terms of lags in the adjustment of prices (see Figure 1). The literature gives two main reasons for such deviations from purchasing power parity: the fact that price structures in the various countries shift over the long term and that the international price link itself can be disturbed by numerous factors. * HWWA-Institut für Wirtschaftsforschung-Hamburg, 198 If the prices of internationally tradable and nontradable goods develop differently within a country and in relation to other countries, the general price level in that country will not be an accurate reflection of purchasing power parities. Such shifts in price structures can occur during a phase of economic growth, for example, if productivity gains affect the tradable goods sector more strongly than the nontradable sector. 2 In this instance, if the prices of tradable goods remain unchanged because they are constrained by the international price link and if at the same time the productivity gains lead to wage increases that spill over into the non-tradable goods sector owing to a close domestic wage link, the prices of non-tradable goods will rise. The general price level therefore also rises without there being any offsetting fall in the exchange rate. In terms of the overall relative price level, the currency appears to be overvalued. 3 A similar argument applies to the effect of divergences in technological development. 4 Besides supply factors such as productivity gains and technical progress, asymmetries on the demand side can also lead to shifts in a country's

price structure. For example, if the income elasticity of demand for non-tradable goods is greater than unity, the prices of nontradable goods will rise in relation to those of tradable goods as incomes increase. 5 However, the supply and demand effects described above need not be induced only by growth; they may also occur as a result of a general change in the structure of the economy, when they will again lead to long-term real exchange rate movements. 6 In certain circumstances, monetary and fiscal policy measures may also have long-term real exchange rate effects by causing a shift in price structures. For example, if such measures induce an increase in residents' net holdings of foreign financial assets, and hence in their net receipts from foreign currency investments, over the long term the country has more foreign currency resources available to buy imports. If certain assumptions are made, this means that proportionately more resources are deployed in producing non-tradable goods and that their prices will rise in relation to the prices of tradables. Here again, the currency of the country in question appears to be overvalued if measured in terms of overall relative prices. Finally, it is frequently pointed out that exogenous disturbances emanating from the real economy can lead to shifts in price structures. Obvious examples of this are the two oil price shocks of 2010/65 and 2015/72, which caused substantial changes of this kind. The causes of deviations from purchasing power parity described hitherto are based on the assumption that there is a very close international price link for tradable goods and that a general price index is not an appropriate yardstick by which to demonstrate it. However, it is also conceivable that for various reasons such a close relationship between prices and exchange rates does not exist, even over the long term. Limited International Price Link

India

We explore the real effective exchange rate (REER) effects on the share of exports of Indian non-financial sector firms for the period 2010-2015. Our empirical analysis reveals that, on average, there has been a strong and significant negative impact from currency appreciation and currency volatility on Indian firms' export shares. Labor costs are found to intensify the exchange rate effects on trade. Further, there is evidence that the Indian firms considered here respond asymmetrically to exchange rates. For instance, the REER change effect is more likely to be driven by a negative appreciation effect than a depreciation effect. Also, Indian firms that have smaller export shares tend to have a stronger response to both REER change and volatility. Compared with those exporting goods, firms that export services are more affected by exchange rate fluctuations. The findings, especially those on asymmetric responses, have important policy implications.

Africa

Africa regions have gone through a process of liberalisation including significant changes in both the nominal and real exchange rate. In the case of Tanzania, the exchange rate liberalisation process started in 1982 with a 10% currency devaluation followed by further devaluations by 20% and 26% in 1983 and 1984 respectively. Both countries have also experienced rapid growth in GDP and exports. Exports as a percentage of GDP have increased in both countries², both economies have become more open, and average tariff rates have been significantly reduced. Overall the process of liberalisation has been slower Africa regions and economy remains less open and more protected than that of different regions. In both cases exports have grown faster than GDP, suggesting that it is exports that lead to growth rather than the other way round. The importance of trade as an engine of growth is well established. Trade

boosts growth by enlarging market opportunities, permitting specialization according to comparative advantage and facilitating access to new technologies. Although the debate as to the direction of causation between exports and growth is contested, there is a consensus that exports are critical for growth, particularly for developing countries. However, the impact of exports on growth is not only influenced by the volume exported but also more importantly by its composition.

Caribbean and Latin America

We analyse the interrelationship between stock prices and exchange rates in the only two Caribbean countries with stock market and floating exchange rates: Jamaica and Trinidad and Tobago in the period 2002-2012. We also study the same four Latin American countries as in Diamandis and Drakos (2011): Argentina, Brazil, Chile and Mexico. Following Lin (2012), who examined the same issue in six Asian emerging markets and also employed the Autoregressive Distributed Lag (ARDL) model bounds test approach proposed by Pesaran et al (2001), we also include interest rates and net international reserves variables in our analysis to avoid any omitted variable bias. We extend Diamandis and Drakos (2011) and Lin (2012) by expanding the ADRL model including a GARCH component to examine the impact of volatility. First, we use the structural break unit root tests of Zivot and Andrews (1992) and Clemente, Montanes and Reyes (1998) to show a significant structural break in the exchange rate, stock prices and our other control variables around the time of the 2008 crisis in all analysed countries, leading us to check our results in three periods: the full sample and in two subsamples before and after 2008. Our results from the bounds test showed a very mild relationship between both variables in Jamaica, Argentina and Brazil, but we cannot find any relationship in the other countries as in Diamantis and Drakos (2011). However, when we include the GARCH

component in the ADRL framework our results changed drastically: stock prices significantly impacted the exchange rate in the tranquil sub-period and the full period for Jamaica, over all three periods for Trinidad and Tobago and in the tranquil period for Argentina, Mexico and Chile. This shows the importance of incorporating volatility explicitly in the model. Our results have the policy implications that governments in the previous countries should try to prevent a currency crisis by stimulating economic growth and the expansion of the stock market to attract capital inflow as in Lin (2012).

Sources of real exchange rate in middle east region

It is well known that a stable real exchange rate plays a central role in economic stability, development, and growth. Real exchange rate stability is crucial to developing countries since it affects capital inflows, foreign direct investment, and trade according to comparative advantage. Caballero and Corbo (1988) study the conditions under which increases in the degree of uncertainty about the real exchange rate depress exports and find a clear and strong negative effect of real exchange rate uncertainty on export performance in several least developed countries. Goldberg and Klein (1997) found that foreign direct investment into some less developed countries is significantly affected by bilateral real exchange rates. There is a general agreement among economists that a severe macroeconomic disequilibrium will evolve as a result of sustained real exchange rate misalignment.

Historically, the Saudi Arabia Monetary Agency (SAMA) preferred to maintain a predictable riyal exchange rate. This fostered economic development and growth, kept prices stable, and promoted international trade. To achieve this goal, the monetary authority adopted a policy of a fixed exchange rate regime. After the collapse of the Bretton Woods System, it became

difficult to maintain a stable riyal exchange rate against the U.S. dollar due to the erratic movements in the value of the U.S. dollar. SAMA switched to the International Monetary Fund's Special Drawing Rights (SDR) unit in 1975 at an exchange rate of 4.28 Saudi Riyal (SR) per SDR with a margin of 21/4 to 71/4 (Looney 1990). On July 22, 2012, SAMA suspended pegging the riyal to SDR; the U.S. dollar became the pegging currency with a range of SR 3.74 to SR 3.75 per dollar

Middle East and north America region

Against the overall trend throughout the world, the majority of the MENA region has continued to maintain de-facto fixed exchange rate arrangements. Empirical analysis suggests that fixed exchange rates are associated with greater levels of exchange rate misalignment, in the form overvaluation, which, in turn, reduce competitiveness for non-oil exporters. In MENA, manufacturing exports – as a percentage of GDP per year – have been reduced by some 18% over the 2010-2015 period as a result of the region's substantial overvaluation of its currency. At a time when developing a strong, export-oriented private sector outside of oil is critical in MENA, there is no room for excessive currency overvaluation. We find that MENA's choice of exchange rate regime – predominantly leaning towards rigid exchange rate arrangements – is less a reflection of structural characteristics of the economies than it is a reflection of the political economy. With a large public sector, which has individual interests as producer of oil and holder of external debt, the interests of the economy are often at odds with the interests of the political economy. If the manufacturing sector has enough power, however, it may lobby effectively for flexible exchange rate regimes.

Conclusion

The examination paper says that the greater part of the locales tradable division execution in respect to its non-tradable segment has been weaker than the best entertainers, yet like that in a few other applicable nations. Hypothesis recommends that swapping scale instability and changeability adversely affect on exporters and those that contend straightforwardly or by implication with imports. However, the hard proof for this is restricted. Some current exact proof recommends there are negative impacts of swapping scale instability and inconstancy at the firm level, however there is no evident confirmation that it brings about a decrease in total fares. The capacity of firms to support here and now unpredictability implies that this paper focuses on the impacts on medium-term inconstancy. It is likely that high swapping scale fluctuation may matter more for than for different nations.

It creates the impression that the connection between swapping scale fluctuation and the execution of the tradable area isn't programmed; numerous different components are grinding away. The way that tradable and non-tradable area patterns are reflected in some different nations recommends that swapping scale inconstancy may clarify some portion of the story in the matter of why tradable part has failed to meet expectations, yet that it can't recount the entire story. This paper recognizes the huge negative effect that a maintained abnormal state of the conversion scale can have on the tradable division.

Since it is hard to know the degree to which swapping scale changeability is compelling the development of the tradable division, it is essential

to be cautious while analyzing arrangement choices. In the event that inconstancy could be decreased - without other negative outcomes - this paper makes the judgment that it is likely the tradable segment would perform better. The absence of sureness about the effect of swapping scale fluctuation on exporters implies that the expenses of different strategies should be considered to guarantee that they don't exceed the advantages.

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