

EXCHANGE RATE AND EXPORTS



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Many magazines mention that “to improve exports, the central banks need to depreciate the currency”.

However what does it mean and how does exports get a boost by depreciating the currency?



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To understand how lowering the exchange rate of a currency affects exports of the country, let me tell you a story



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Mr Aam is a mango seller. His mangoes are amongst the best in the market. He sells them for Rs 1000 per dozen. He also exports mangoes to Mr Mango in USA.



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Let's say the exchange rate is Rs 50 for a dollar. In other words it means that if Mr Mango were to pay \$1 he could buy Rs 50 from a currency exchange.



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So if \$1 gets him Rs 50, he would need \$20 to buy Rs 1000

($1000/50 = 20$)

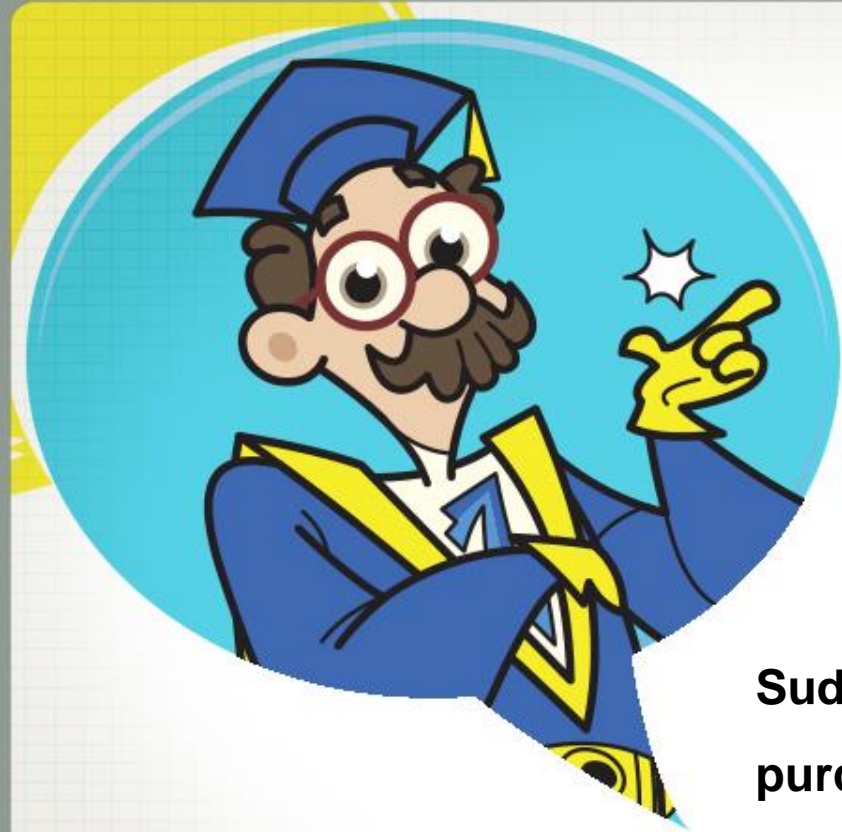
So he first purchases Rs 1000 by paying \$20

Then he pays the Rs 1000 to Mr Aam for a dozen mangoes.

Hope it is quite clear till now.



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Suddenly one day Mr Mango stops purchasing mangoes from Mr Aam. On enquiring, Mr Aam finds out that Mr Mango is buying from another country as he is getting them for \$15



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To sell at \$15, it would mean that Mr Aam would have to sell a dozen for Rs 750.

Mr Aam realizes that its nearly impossible to sell at this price. Far from earning profits he would be making a huge loss



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Now Mr Aam goes to the union of mango sellers who send a representative to the government with a request that instead of selling Rs 1000 for \$20, they should make the rupee cheaper and sell Rs 1000 for \$15 only.



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Since the representative is strong and since even exporters of other products had made similar requests, the government relents and makes the rupee cheaper such that Rs 1000 would be sold for \$15. So now for \$15 Mr Mango can once again buy Rs 1000 or for \$1 he can now buy 66.67 rupees.



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Thus the seemingly upwards movement from Rs 50 to Rs 66.67 actually is the lowering of value of the rupee because now \$1 can fetch Rs 66.67 instead of the Rs 50 which was possible before the depreciation (or value reduction)



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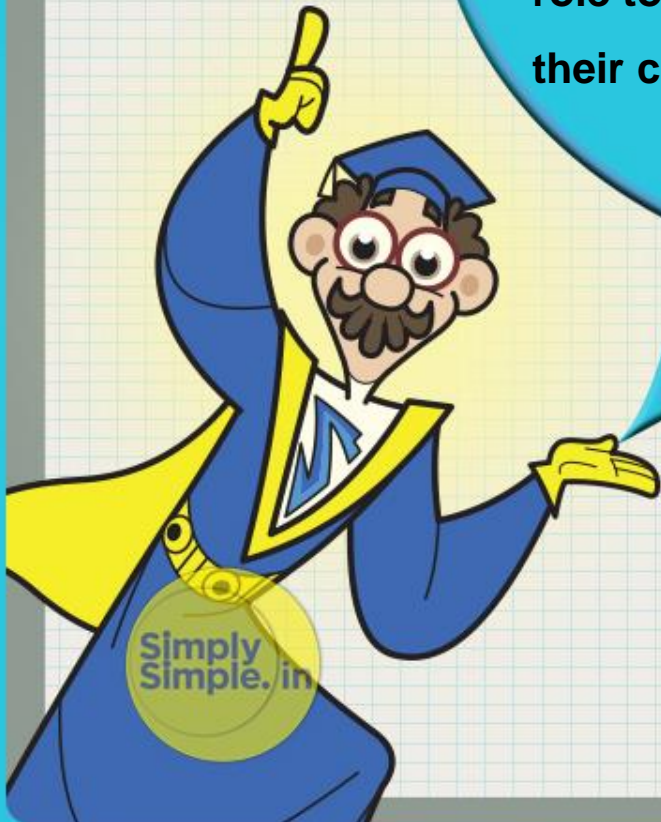
Since rupee depreciation brought the value of the Rs 1000 down to \$15 (which Mr Mango was paying for mangoes in another country), he now restarts his business relationship with Mr Aam.

Thus by depreciating the rupee the Indian government helps exporters like Mr Aam.



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Hope you've understood the relationship between exchange rate and its impact on exports and how government can play a role to help exporters by depreciating their currency



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Hope this lesson has succeeded in clarifying the concept of “to improve exports, the central banks need to depreciate the currency”.



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