

Option 1, Enquiry 2: Competitive advantage and exchange rates

Learning outcomes	
1	Revising prior knowledge of exchange rate changes.
2	Analysing the links between the exchange rate and the level of exports and imports, and the amount of revenue generated.

Resources	Student sheets and sources of recent data on exchange rates.
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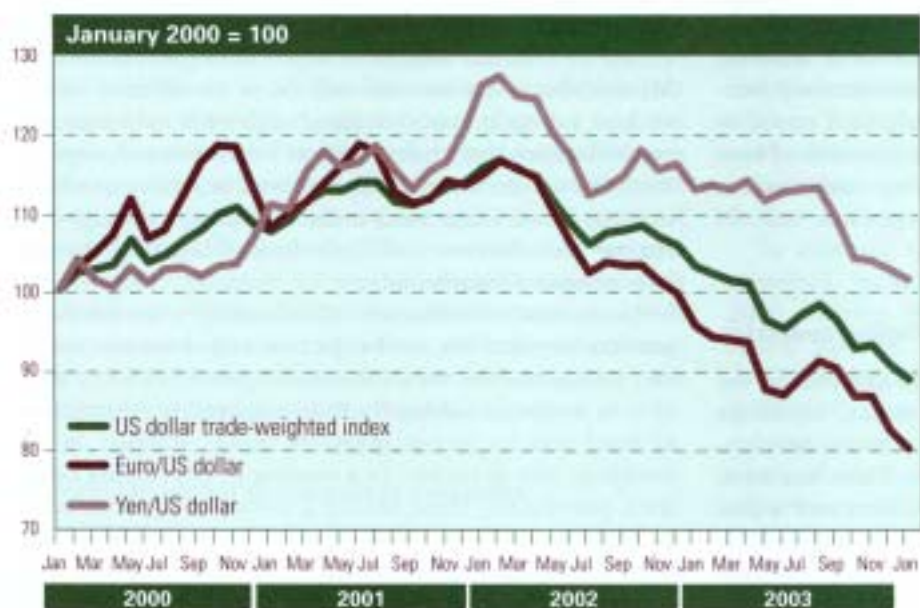
Time	1 hour
Running the activity	This looks like a data response question but the questions are challenging and discussion of the likely outcomes will help to clarify the issues. The data is relevant to events in 2004 and early 2005. After that, students will be able to think about how this situation compares with current trends.

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Before starting on this question, you might find it useful to revise work done on exchange rates in Module 3.1.

Discuss the questions in groups before drawing conclusions.

The US dollar has been depreciating on the foreign exchange markets. The reasons for this are connected to the policies of President Bush and the long-standing US government deficit. Figure 1 shows how the dollar has moved.



Source: Federal Reserve Board, European Central Bank

Question

How will European businesses that look to export to the US be affected by this change?

China

For the Chinese economy, export markets are enormously important. Exports were equal to 49% of GDP in 2002 and are probably still growing fast. China is a dual economy - it has two contrasting sectors. The developed part of the country, which includes all the coastal areas, has a large manufacturing sector and produces the bulk of China's exports. The inland areas which are predominantly agricultural are much less involved in the global economy, producing mainly for local and national markets. Incomes are much lower in this sector than in the eastern coastal regions.

For many years, the Chinese currency, the yuan, has been pegged to the US dollar. That means that its value in terms of other currencies has been determined by the dollar exchange rate.

Questions

- 1 How would you expect the dollar exchange rate to have affected the competitiveness of Chinese manufactures within the world economy over the past two years?
- 2 What will have happened to export prices in, say, Europe?
- 3 What will have happened to exports and export revenues?

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China's economic growth

Figure 2 shows rates of growth of per capita income in US dollars for a range of Asian countries. It also provides per capita income in 2002 in purchasing power parity terms. This provides income comparisons based on purchasing power. In other words, it gets away from the distorting effect of exchange rates. A low exchange rate underestimates the dollar value of incomes because it makes products look cheap.

Income growth in selected Asian economies

	GDP growth, 2001-02	Per capita GDP growth, 2001-02	PPP per capita income, US\$
China	8.0	7.3	4,520
India	4.6	3.0	2,650
Indonesia	3.7	2.3	3,070
Korea	6.3	5.7	16,960
Malaysia	4.1	1.9	8,500
Thailand	5.4	4.7	6,890
Vietnam	7.0	5.8	2,300

Source: World Bank, World Development Indicators, 2004

Questions

- 1 On the basis of the data you have, what would you expect to be happening to China's imports?
- 2 Supposing the dollar now rises and the yuan continues to change with it, automatically as at present. What effect would this have on China's trade balance?
- 3 How does China differ from other Asian economies?

Special question not to be answered until after September 2005

- 4 What actually did happen, if anything? Was China able to maintain its high rate of export and income growth? Find recent data if you can.

*This document has been downloaded from the Nuffield Economics and Business site
www.necb.org*