**Exchange Rates**

**Following the Guidelines of the American Psychological Association**

**Name**

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**Course**

**Date**

Introduction

This essay will respond to the following questions. What is the importance of exchange rates? Who benefits and who loses when a country’s currency appreciates? Who benefits and who loses when a country’s currency depreciates? In the long run, what are the major factors that impact exchange rates? Understanding that central banks impact exchange rates, select three central banks and demonstrate/ explain how this occurs. I will also include at least three professional references for this essay and follow the American Psychological Association (APA) formatting.  
Importance of Exchange Rates

According to Obstfeld (1996), the importance of exchange rates are to promote currency exchanges across businesses and individuals globally. Without exchange rates, there would be equal standardized currency trade throughout the world. However, exchange rates exist because each country has a unique history, a unique people and a unique financial situation that reflects in the value of its currency internationally. When one country wants to do trade with another country, each country that is mutually trading needs to ensure that they are trading the goods, services, products, etc. based on the currency value of each individual country.

An example of this would be a magazine owner in Canada who has a writer in India. The current Canadian currency value against the American dollar is $1.33 CAD compared to $1.00 USD. When you compare Canadian currency which would be $1.00 CAD compared to the Indian rupee, the exchange rate equates to $49.8 Indian rupees. This would mean that a Canadian magazine owner who chooses to work with an Indian writer and to pay them $30.00 for a year’s worth of work is actually paying that writer $1,494.02 in Indian rupees. The Indian writer is earning more money because they are receiving the funds in Canadian currency. The dilemmas that arise with this situation is that the Canadian magazine owner has outsourced a job to someone who is non-Canadian which means that the $30.00 she pays is not going into the Canadian economy.

The same happens in America. This is why exchange rates are partially a political issue particularly when you tie currency to income that people earn and work that is international. This is not the focus of this essay; however I bring up this subject because this could be the focus of future research on exchange rates.

Currency Depreciation

When a currency depreciates, according to Mundell (1963), the main winners of this tend to be the tourism industry of any particular country. If for example the currency of China depreciates, there would be more Americans, businesses in particular, who would want to do business with China. This is not tourism; however the incentive to visit China in order to conduct business would be encouraged by a depreciating currency value in China. As well, people all over the world, particularly in places such as Europe and Western populated countries with higher currency rates than China would be encouraged to travel to China if the currency of China were to depreciate. Currently the Taiwanese new dollar is weak against the American dollar. One U.S. dollar is equal to $31.48 Taiwanese new dollars. This would definitely encourage an American with money to travel to China.

Currency Appreciation

When the exchange rates dictate that a country’s currency is strong on the international markets, the tourism industry suffers. However, in general, businesses do very well in this situation, as well as the banking industry. In a country is in a powerful position such as the United States where other countries are in a position to need to trade and do business with the United States – the country will simply need to pay the differences that occur from their weak dollar compared to the strong American dollar. However, some countries may look for alternatives and this would actually create a situation where America (as an example) would lose some business (Goldberg & Knetter, 1996).

Impacts on Exchange Rates

There are many things that impact exchange rates. The current political situation in a country is one of the major reasons why exchange rates will fluctuate (Dornbusch, 1976). Currently, the American political campaign for President is affecting the American dollar throughout the exchange rates in the world. Due to the uncertainty of exactly who the next President of the United States will be, this affects how people choose to invest in America, as well as do business with America in a variety of forms which can also include foreign students studying in America, stocks and bonds, people choosing to purchase real estate and also goods and services in America.

Central Banks

According to Lubik & Schorfheide (2007), the central banks play a key role on the exchange rates of any given country. The central banks set the interest rates which affect the flow of money in any given country and also affect how powerful that currency is on the international market based on how the people of that particular nation are utilizing the currency available on the market. Interest rates play a key role in how people utilize money in an economy, particularly for “big ticket” items that truly drive the financial markets.

The central banks that I will focus on are the Federal Reserve, The Bank of England and The Bank of Canada.

The Federal Reserve currently has its interest rate at 0.49% on average for the month of October 2016 (Board of Governors of the Federal Reserve System, 2016). The Bank of England’s interest rate is 0.25% (Bank of England, 2016). The Bank of Canada’s interest rate is 0.5% (Bank of Canada, 2016). When you look at the exchange rates of all of these countries, the United States and the United Kingdom have higher currency value when compared to Canada and this can be reflected in the exchange rates.

Conclusion

This essay has assessed the meaning, the value and the importance of exchange rates.

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