The Indicators Pertaining to the Dollar and Euro Exchange Rate

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No Country can grow and increase productivity by itself. Certain raw materials and expertise are requested to make a win-win situation for all the parties in an international transaction between two different countries. When countries deal, they need a currency exchange rate to decide the worth of their merchandise in foreign currency and pay the required amount to the other party in the transaction. The Global Corporate World is doing daily business of $5.5 Trillion. Exchange rates prove to be the deciding rates of currency that further aid in making international business transactions. It is set by foreign exchange markets and is volatile. The decision is a mix of several variables, such as the interest rates in the countries, Strength of the economy and outstanding loans. In short, the Exchange rate values domestic currency regarding foreign currency. The exchange rate is an interesting concept that rules the global corporate World. The United States Dollar is considered the global currency, and all other currencies are checked for their worth against the Dollar. The exchange rate involves two currencies. The foreign currency is taken as the base currency, which is Dollar in the most global markets, and the domestic currency is weighed to counter the base currency. The euro is special because the Dollar is weighed regarding the Euro in international transactions. Euro has proven to be defining the exchange rate against its appreciation and depreciation over the last decade. (Lucio Sarno, 2003).

Determinants of Euro-Dollar exchange rate

Several variables affect the exchange rate, such as inflation differentials, Relative pricing, Interest rates, and Political and economic environment play an important role in the exchange rates of different currencies in the international economy. The euro-Dollar exchange rate has a high impact on the European market. The euro was worth 11.8% against the Dollar in 2016. This shows the steadiness of the Euro against the discrepancies in the exchange rate. The worth of Currency is determined by the demand and supply of money in the foreign exchange market. Capital cash flows and trade debt flow affect the exchange rate. The government intervenes in managing the worth of its currency through alterations in interest rates and fiscal policies. The major factors affecting the Euro-Dollar exchange rate include the interest rate differential between the United States dollar and Interest rates in the home country. The relationship between prices of business and non-business goods and services in the countries. Another major factor that affects the exchange rate is the international oil prices and other minerals. The last but not the least factor affecting the exchange rate of the Dollar and Euro is the fiscal position of the trading countries.

Factor Incrementing the Dollar price of Euros

Several factors can increase the price of the Dollar against the Euro. Interest rates are one of the factors that can appreciate the Dollar against the Euro. Increasing interest rates predicts a high rate of return on investment in a country, thus increasing the value of its currency and increasing the exchange rate. Another major variable in play is the inflation rate that affects the interest rates thus affecting the exchange rate in the long run. The high interest rate tends to increase the exchange rate of the Dollar against the Euro and vice versa.

Factor depreciating Dollar Price of the Euro

The foreign exchange rate determines the economic health of a country. The balance of payment is the monetary mix of all the transactions that take place between two trading economies over a fixed period. This shows the total amount of business transactions and allows the economist to devise policies for the long run to avoid the negative impact of trade deficits on the economy of a country. A deficit in the balance of payment states that the worth of imports is higher than the worth of exports. There is an assumption that if the current account deficit is covered with a Surplus in the economy, then it might have less effect on the depreciation of currency; however, if the economy struggles to increase the capital inflows so that the deficit is maintained, face depreciation in the Dollar. The United States had a 7% current account deficit that played a fair role in the Depreciation of the Dollar at the start of the financial crisis (Yomba, 2009).

Relationship of Dollar and Euro Exchange rates

The euro and Dollar are the two major international currencies that affect international trade transactions. An increase in the Dollar price against the Euro predicts a decrease in the Euro price as the Euro appreciate and depreciates in comparison with the Dollar and vice versa. It means that more dollars are required to purchase a Euro, and on the other end, it takes fewer Euros to purchase Dollars. The relationship between exchange rates of currency is a complex economic area that is influenced by many factors. The exchange rate affects the prices of goods and services in an economy as it affects the interest rates and inflation rate, thus affecting the final consumer either positively or negatively.

Purchasing power parity & Exchange Rate

In Macroeconomics, there are several metrics used to analyze and measure the strength of the economic conditions of a country. Purchasing Power Parity is a metric used to compare the base currency and counter currency by applying the rates to a defined basket of goods. It is assumed that if inflation rates in both the trading countries remain the same then their currency are equal in worth.

For understanding purposes, assume one Dollar is equal to one Euro. It means that the price of a basket of goods remains the same as the inflation rate is stable, and currency equalizes each other thus securing the investors. However, in real economic conditions, there is always a change in the prices and currencies due to the multiple variables affecting the exchange rates. Purchasing power parity theory suggests that the dependence of the consumer on the final product to purchase the goods and services is not dependent on the currency he is dealing with, it is dependent on the purchasing power of the currency in the market. The purchasing power of the currency is determined by the international market in comparison with the domestic market.

In the long run, the purchasing power parity theory determines the differential in the market rate of different currencies and tries to mitigate the effect through changes in the exchange rates. The difference in the exchange rate determines the profit value for the countries and allows them to earn the arbitrage profit. Purchasing goods and services in an economy where prices are low and selling them in a country where the exchange rate is high (Yomba, 2009) would benefit the investors. In short, the Purchasing power parity theory suggests that the prices of a mix of commodities need to be equal in both markets so that the prices are equalized through the exchange rate. However, the real economic scenarios are different, and the purchasing power parity theory doesn't always work in practice (Bahmani-Oskooee, 2013).

Import Quota and Tariff

Import Quota is the pre-decided quantity or Worth of Defined goods and services that are imported by a country during a fiscal year. A quota places an embargo on the purchase of items by a country once the quota is filled. On the other hand, tariffs are the duties and charges on the international currency or the physical quantities of goods and services. The tariff allows the purchaser to purchase goods as required and pay the relevant excise and customs duties to pass the goods to the home country. Tariffs are tools used by authorities to restrict the imports of certain goods and services into the country. A tariff is a feasible option for an economy due to the liberty it allows the governments to control the goods and services going out and coming in into the country. Tariffs are more beneficial to an economy as compared to Import quotas; the reason is that Tariff generates revenue and is dependent on the number of goods and services imported into the country. On the other hand, quotas, once filled, can't be crossed. Import quotas are prone to corruption at the administrative level. In short, a Tariff is a preferable option and less harmful due to the lower risk of corruption and the control the government has on the revenue of tariffs. There is an economist who is of the view that import Quotas and tariffs are risking international trade and restricting it in one way or another. Economist suggests a free market economy where no restrictions are placed, and the government works to maximize business with the international World. Tariffs are feasible when there is an increase in demand for imported products. If the demand increases investors and importers have the option to import more goods to sustain the supply and demand of the product. In Import Quota, there is a restriction which will increase the prices of imported goods in the domestic market due to the increase in demand and the embargo on more imports in the import quotas system.

References

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