**Exchange Rates**

The value of one currency, in terms of another currency

Calculating the effect of exchange rate on prices

* To find the price of a UK product abroad **MULTIPLY** the UK price by the value of the foreign currency
* For example, if the exchange rate is £1= E2 and a good costs £200 in the UK, the price in France will be E400 (£200 x 2 Euros = E400)
* If the exchange rate is £1 = E1.2 and a good costs £10,000 in the UK, the price in France will be E12,000 (£10,000 x 1.2 Euros = E12,000)
* To find the price of a foreign good in the UK **DIVIDE** the foreign price by the value of the foreign currency
* For example, if the exchange rate is £1 = $3 and a good is sold for $300 in the USA, the price in the UK would be £100 ($300 divided by $3 = £100)
* If the exchange rate is £1 = $2 and a good is $10,000 in the USA, the price in the UK would be £5000 ($10,000 divided by $2 = £5000)

Summary of the effect of increased exchange rates on UK firms

* An increase in the exchange rate (or a rise in the value of the pound) occurs when pounds can buy more of other currencies
* For example, if the exchange rate goes from £1=$2 to £1=$3
* The price of UK firms’ products rise aboard
* Therefore, **UK firms sell less abroad**
* The price of foreign products sold in the UK becomes cheaper
* Therefore, **UK firms sell less in the UK**
* **Imported raw materials are cheaper**
* Therefore, UK firms that buy materials from abroad will have lower costs

Summary of the effect of reduced exchange rates on UK firms

* A decrease in the exchange rate (or a fall in the value of the pound) occurs when pounds can buy less of other currencies
* For example if the exchange rate goes from £1=£1.5 Euros to £1= 1.2 Euros
* The price of UK firms’ products abroad falls
* These cheaper prices mean that **UK firms sell more abroad**
* The price of foreign products in the UK increases
* Higher price foreign products mean that UK firms selling in the **UK are more price competitive and so can sell more in the UK**
* **Imported raw materials are more expensive**