

Exchange rates: Strong Pound

Instructions:

This exercise is designed to bring out some of the good and bad features of a strong or weak currency based on the UK's recent experience. It is best used towards the end of the topic, because some of the points in the article are quite sophisticated and some of the questions pre-suppose knowledge of exchange rate supply and demand diagrams.

This is probably best used as a pair-based exercise, allowing students to share knowledge and puzzle things out between them.

Why the strong pound is not all good news

By Katie Hope

Business reporter, BBC News

The pound has risen about 13% against the dollar over the past year

“It just hasn’t levelled off and seems to be increasing month-on-month without slowing down,” Rex Baynton tells the BBC. Over the past year, sterling has gained about 13% against the dollar and about 10% against the euro, reflecting investors’ conviction that interest rates will rise before the end of this year.

Why might “investors’ conviction that interest rates will rise before the end of this year” have caused the pound to strengthen? Show on a diagram.

Against emerging market currencies, the rise has been even more dramatic, with the pound surging 24% against the Turkish lira.

While those just about to head overseas on their summer holidays may be cheering at the extra spending money the pound’s soaring strength will give them, for British firms like Stephens Gaskets, which export their goods overseas, it is beginning to be pretty painful.

Stephens Gaskets exported between 50% and 60% of the gaskets and “shims” - washers or thin pieces of material used to make parts fit or reduce wear, for instance between two car parts - it made over the past year.

And while the specialist nature of many of its products has meant demand has remained strong, Mr Baynton says he is now concerned about the strength of the pound, particularly against the dollar, because it will mean its US competitors’ products are cheaper.

Explain the statement: “the specialist nature of many of its products has meant demand has remained strong”

“I’m starting to worry. We are reaching the point where customers are going to ask what we will do about it. Customers are going to say we need to cut prices, which will obviously cut profit.”

Large British firms, which need to translate the profits made overseas back into pounds for reporting purposes, are also feeling the pain.

Luxury fashion brand Burberry said recently that if it adjusted its 2014 profit according to the current exchange rate, it would be a whopping £55m lower. If the pound’s rise continues, it said the impact on profit would be “material”.

Explain the paragraph about firms making profits in \$.

But it's not all bad. Essentially, the rise in the pound creates “winners and losers”, says Samuel Tombs, senior UK economist at Capital Economics.

One of the winners, he notes, will be the man on the street as the pound's upward march will help to reduce shop prices as retailers are able to buy more goods for the same amount of money.

“Prices won't move straight away because retailers have contracts to buy at a certain price so it will take up to nine months to affect prices,” he says. “But this will help to support living standards and should start to bring about an increase in real earnings.”

Drivers also benefit as Angus Campbell, a senior analyst at currency trading platform FxPro, explains: “Oil is priced in US dollars, meaning that the strong pound reduces the price of petrol.”

Why will the impact on consumers not be immediate?

And of course the most obvious group of winners are those travelling abroad, but for those currently suffering from the pound's strength, there is one indisputable fact which should reassure. What goes up, must at some point come down. And when the pound does eventually begin to drop, they will in turn start to benefit.

Source: BBC News Website (25/07/2014)

<http://www.bbc.co.uk/news/business-28332400>