
'Staycations' and weak pound have boosted British trade, says Bank of England

The weak pound has boosted Britain's trade position, helped by Britons taking fewer holidays abroad, according to the Bank of England.

"By making UK exports more competitive and imports into the United Kingdom less affordable, weaker sterling should boost export volumes and reduce import volumes"

Bank of England, Dec 2011

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Weak pound boosts UK export orders

By Norma Cohen

Export orders from UK manufacturers were higher than normal in May, the first time that demand from abroad has been above par in more than two years, according to a closely watched survey.

The CBI's monthly industrial trends survey found that 3 per cent more manufacturers described their export orders as "above normal" than below normal, the first time this has happened since March 2008 as the UK recession began to bite.

"The weak pound has made UK exports more attractive, and manufacturers are benefiting from the pick-up in world trade," said Ian McCafferty, the CBI's chief economic adviser. He noted that employers also were expecting a stronger rise in overall production in the coming months.

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Financial Times May 2010

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Mail Online

Weak pound is here to stay warns Bank of England expert as he says new round of quantitative easing is close

- Move a bid to improve affordability of UK exports
- Households set to struggle as imports and foreign travel become more expensive

Sterling has lost around 30 per cent of its value against the U.S. dollar since the financial crisis as the impact of recession, low interest rates and quantitative easing all depreciated the currency.

A weak pound can hit households as the cost of imports are relatively higher and travelling abroad becomes more expensive, however UK exporters will benefit as the value of their products becomes more attractive to overseas buyers

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What is an exchange rate?

An exchange rate is the **price of one currency expressed in terms of another** currency

The exchange rate determines how much of one currency has to be given up in order to buy a specific amount of another currency

£1 = $1.50

For every £1, you can buy $1.50 US dollars
This is the price of one pound, expressed in dollars i.e. the £/$ exchange rate

Exchange rate changes

£1 buys	May	September
US Dollars ($)	$1.60	$1.45
Euros (€)	€1.15	€1.05

In the table above, you can see that in May, £1 would buy $1.60, if you wanted to convert some pounds into US dollars. Alternatively, £1 would buy €1.15 euro. What happened to the exchange rate for the pound between May and September?

The value of £1 fell against both the US dollar and the Euro. For example, by September, £1 would only buy you $1.45, a fall of $0.15 from May.

That means that the pound **weakened** against the dollar (and the euro). Putting it another way, the value of the US dollar strengthened against the pound. If you were holding dollars, you would need less of them to convert into £1.

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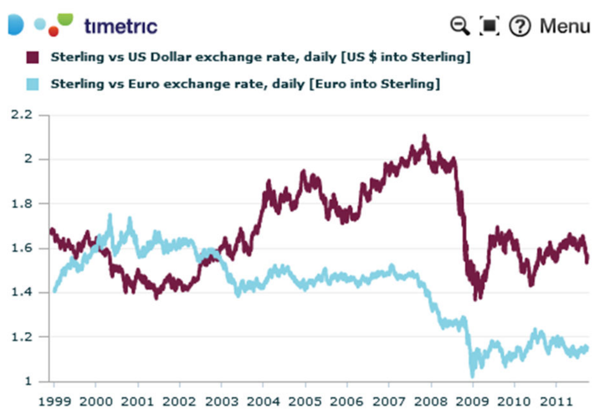

Exchange rate winners and losers

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S Stronger
P Pound
I Imports
C Cheaper
E Exports
D Dearer

A stronger pound makes it cheaper to pay for imports, but exports will seem more expensive to overseas customers

Fantasy Football hit by the weakness of sterling

Friday, July 17, 2009

by Penny Brooks

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Giving a European player a net annual salary of 3m euros (£2.6m) would cost an English club 6.8m euros. But a Spanish club needs only pay 4m euros to deliver the same net salary

Effects on business - factors

Low effect on business	High effect on business
No export sales – turnover all in domestic (UK) market	Significant export sales, perhaps in many currencies
All business activities located in UK	Overseas operations, earning profits in foreign currency
Raw materials and other supplies bought in UK	Significant purchases from overseas suppliers
Demand predominantly from domestic (UK) customers	Substantial demand from overseas visitors to UK
Demand is price inelastic	Demand is price elastic
Higher costs can be passed on to customers to maintain margin	Higher costs usually have to be absorbed via a lower margin

Example – exporter, strong pound

Budgeted Export Sales 2010		
Exchange rate: £1 =		$1.50
Selling price in export market	Per unit	$1,500.00
UK production cost	Per unit	£300.00
Selling price (revenue) in £	Per unit	£1,000
Production cost (£)	Per unit	£500
Gross profit (£)	Per unit	£500
Units sold per year in US Market	Qty	2,500
Budgeted revenue for year	£'000	£2,500

If the US selling price remains the same in £ terms, what happens to annual revenue if exchange rate rises to £1 = $1.75?

Exchange rate: £1 =		$1.75
Selling price in export market	Per unit	$1,750.00
UK production cost	Per unit	£300.00
Selling price (revenue) in £	Per unit	£1,000
Production cost (£)	Per unit	£500
Gross profit (£)	Per unit	£500
Units sold per year in US Market	Qty	2,000
Revenue per year	£'000	£2,000

- US$ price rises – the UK product becomes **less competitive**
- Quantity demanded in the US falls - % fall depends on price elasticity of demand
- Revenue falls from £2.5m to £2.0m

Example – importer, weak pound

June 2009	
Selling price in UK per unit	£50.00
Imported cost per unit	€ 30.00
Exchange rate £1 =	€ 1.20
Imported cost per unit	£25.00
Quantity sold per month	5,000
Revenue	£250,000
Cost of Sales	£125,000
Gross Profit	£125,000
Gross Margin	50.0%

The importer makes a 50% gross margin at a rate of £1 = € 1.20 at a selling price of £50 per unit

What happens to gross profit and gross margin if the Pound (£) falls in value against the Euro (€) to parity?

October 2009	
Selling price in UK per unit	£50.00
Imported cost per unit	€ 30.00
Exchange rate £1 =	€ 1.00
Imported cost per unit	£30.00
Quantity sold per month	5,000
Revenue	£250,000
Cost of Sales	£150,000
Gross Profit	£100,000
Gross Margin	40.0%

- A weaker pound makes it more expensive to buy imports in Euros
- The bought-in cost per unit rises from £25 to £30
- The gross profit per unit falls from £30 each to £25
- Gross margin falls from 50% to 40%

How can businesses manage exchange rate uncertainty?

- **Monitor** and try to **anticipate** exchange rate movements
- Used **sensitivity analysis** to calculate profitability at different exchange rates
- Pre-buy and pre-sell currency at favourable exchange rates (**hedging / currency options**)
- Set up bank accounts in different currencies to reduce currency transactions and offset the effects of currency movements