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The effect of the exchange rate on inflation

Technical box extracted from:

Inflation Report no.3, August 2012 [1]

The magnitude and persistence of shocks arising from changes in the exchange rate level of the national currency against the currencies of major trading partners have an impact on inflation. Any appreciation or depreciation of the national currency can have a significant impact on inflation in a small open economy like Moldova's economic system.

The fluctuations and changes in the exchange rate can affect the prices through a direct transmission channel and an indirect transmission channel.

The first transmission channel has a direct impact on inflation as a result of any fluctuations or changes in the exchange rate. Direct transmission on the level of inflation from exchange rate change occurs through import prices that are adjusted to a new level following the changes in the exchange rate with a relatively small lagLag – a period of latent time in the development of a phenomenon.. The magnitude and persistence of shocks received from exchange rate fluctuations have an effect on prices of goods and services imported for final consumption of households, and the raw materials and intermediate products designated for final consumer goods production.

The indirect transmission channel has several ways of transmission of the effect on the price level following the changes in the exchange rate of the national currency against the currencies of major trading partners. One of the indirect influence effects of the price level of goods on domestic market, following the changes in exchange rate, shows its effects through the import arbitration. The consequences resulted from the effect of imported arbitration is denoted by adjusting the price level of goods on domestic market under the competitive pressure of imported goods and services.

The indirect impact from exchange rate depreciation occurs through real exchange rateReal exchange rate – is the relative price of goods and services in two countries. The real exchange rate expresses the rate at which you can sell goods and services of a country for goods and services of another country.. The modification of the real exchange rate has the ability to influence the aggregate demand. The national currency depreciation determines the domestic products and services to be less competitive, which has a negative effect on export volumes. The decline in exports has a negative impact on the economic activity in general, the aggregate demand being mostly affected and later the inflation. The impact of changes in the real exchange rate is relatively low for the Moldovan economy and for the economies of other countries.

Vezi și

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Sursa URL:
http://bnm.md/ro/node/52584

Legături conexe:

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