From the GLOSS•arama

TARGETING STRATEGY: The initial step in the target market/segmentation process by which a company develops an overall picture of who the specific buyer group might be. The three types of strategies are: undifferentiated, differentiated, and concentrated. Targeting strategies are based on whether the market is homogeneous or heterogeneous.

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A B C D E F G H I J K L M N O P Q R S T U V W X Y Z #

EXCHANGE RATES, AGGREGATE DEMAND DETERMINANT:

> One of several specific aggregate demand determinants assumed constant when the aggregate demand curve is constructed, and that shifts the aggregate demand curve when it changes. An increase in exchanges rates causes an increase (rightward shift) of the aggregate curve. A decrease in the exchanges rates causes a decrease (leftward shift) of the aggregate curve. Other notable aggregate demand determinants include interest rates, the money supply, inflationary expectations, consumer confidence, and the federal deficit.

An exchange rate is the price of one currency in terms of another, the rate at which one currency can be exchanged for another. For example, the exchange rate between U.S. dollars and British pounds is the price of buying one British pound in terms of the amount of U.S dollars paid.

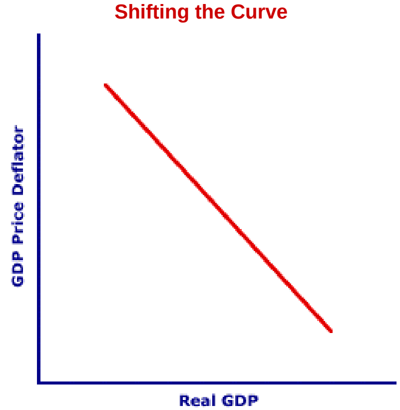
An exchange rate of $2 per pound means that anyone buying one British pound pays a price of $2. Moreover, every nation has currency exchange rates between their domestic currency and other countries. The United States has exchange rates, not only with British pounds, but Japanese yen, French francs, Mexican pesos, Canadian dollars, and a whole lot more.

Exchange rates surface as an aggregate demand determinant because they effect the relative prices of imports and exports, and thus the net exports component of aggregate expenditures. When exchange rates change, the relative prices of exports and imports also change, which causes exports, imports, net exports, and thus aggregate demand to change.

- An increase in the exchange rate, that is, the price of buying foreign currency in terms of domestic currency increases, causes an increase in net exports and an increase in aggregate demand.
- A decrease in the exchange rate, that is, the price of buying foreign currency in terms of domestic currency decreases, causes a decrease in net exports and a decrease in aggregate demand.

This graph to the right presents a standard aggregate demand curve. Like all aggregate demand curves, this one is constructed based on several ceteris paribus aggregate demand determinants, such as exchange rates. The key question is: What happens to the aggregate demand curve if exchange rates change?

Shifting the Curve



Higher Rates | Lower Rates | Reset

Higher Exchange Rate

Suppose, for example, that an organization of central bank representatives from several of the largest nations in the world (call this group G-8) decide that the currency exchange rate of $2 per pound between U.S. dollars and British pounds is too low. These representatives, through their respective central banks, take the steps necessary to increase the exchange rate up to $2.50 per pound.

This higher exchange rate means that U.S. consumers pay more for any goods purchased from British producers (that is, imports). A British-made car selling for 10,000 British pounds in Britain costs U.S. consumers $20,000 at the original exchange rate and $25,000 at the new exchange rate. At this higher price, U.S.

MICRO•scope

WHITE GULLIBON
[What's This?]

Today, you are likely to spend a great deal of time going from convenience store to convenience store trying to buy either a set of tires or a birthday gift for your grandfather. Be on the lookout for telephone calls from former employers.
Your Complete Scope

This isn't me! What am I?

Did You Know?

Two and a half gallons of oil are needed to produce one automobile tire.

F•amos Quote

"When the solution is simple, God is answering."

-- Albert Einstein

ACRO•phobia

QJE
Quarterly Journal of Economics

Reading Room

A PEDestrian's Guide
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consumers are bound to buy fewer British-made products, causing imports to decline.

On the other side of the net export equation, British consumers pay less for goods purchased from U.S. producers (that is, exports). An American-made music CD selling for $20 in the United States costs British consumers 10 British pounds at the original exchange rate and 8 British pounds at the new exchange rate. At this lower price, British consumers are bound to buy more American-made products, causing exports to increase.

With imports falling and exports rising, net exports unquestionably increase. And with this increase in net exports goes an increase in aggregate demand. To see how an increase in the exchange rate of U.S. dollars for other currencies affects the aggregate demand curve, click the [Higher Rated] button. The higher exchange rates cause an increase in aggregate demand, which is a rightward shift of the aggregate demand curve.

Lower Exchange Rate

Alternatively, suppose that this G-8 organization of central bank representatives decides that the currency exchange rate of $2 per pound between U.S. dollars and British pounds is too high. In this case the representatives work through their respective central banks to decrease the exchange rate down to $1.50 per pound.

This lower exchange rate means that U.S. consumers pay less for any goods purchased from British producers (that is, imports). A British-made car selling for 10,000 British pounds in Britain cost U.S. consumers $20,000 at the original exchange rate and $15,000 at the new exchange rate. At this lower price, U.S. consumers are bound to buy more British-made products, causing imports to rise.

On the other side of the net export equation, British consumers pay more for goods purchased from U.S. producers (that is, exports). An American-made music CD selling for $20 in the United States cost British consumers 10 British pounds at the original exchange rate and 13.33 British pounds at the new exchange rate. At this higher price, British consumers are bound to buy fewer American-made products, causing exports to decline.

With imports rising and exports falling, net exports unquestionably decrease. And with this decrease in net exports goes a decrease in aggregate demand. To see how a decrease in the exchange rate of U.S. dollars for other currencies affects the aggregate demand curve, click the [Lower Rates] button. The lower exchange rates cause a decrease in aggregate demand, which is a leftward shift of the aggregate demand curve.

What Does It Mean?

Exchange rates are occasionally overlooked as an aggregate demand determinant. The primary reason is that exports are the smallest of the four aggregate expenditure components, which means that relatively big changes in net exports are needed to generate noticeable changes in aggregate demand. But, it does happen. And when it happens enough, the domestic economy can be stimulated to an expansion or thrown into a contraction.

Another possible reason for this lack of notoriety is that the powers-that-be in a country (that is, domestic producers) generally promote the higher exchange rate option to discourage imports and encourage exports. Producers face less competition from foreign products and export more production to other countries. The lower exchange rate option that would trigger the opposite result is seldom promoted. The higher exchange rate seems to be a "fact of life" and it is how the "world should be." No questions. No debate. But it is only one side of the possibilities.

Ch...Ch...Changes

Be careful not to confuse changes in exchange rates, as an aggregate demand determinant, with the net-export effect. While both involve the imports, exports, and relative price levels between countries, each is a distinct phenomena. The net-export effect comes about because changes in the price level cause changes in net exports and aggregate expenditures and thus movements along the aggregate demand curve.

By way of contrast, exchange rates as an aggregate demand determinant causes changes in aggregate demand and shifts of the aggregate demand curve. This determinant operates because something OTHER THAN THE PRICE LEVEL causes a change in exchange rates.

<= EXCHANGE RATE POLICIES EXCHANGE RATES, AGGREGATE EXPENDITURES DETERMINANT =>

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Or For A Little Background...

| aggregate demand | aggregate expenditures | aggregate demand and market demand | determinants | gross domestic product | consumption expenditures | investment expenditures | government purchases | net exports | price level | real production | GDP price deflator | real gross domestic product | foreign sector | exports | imports |

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