Additional case study: Exchange rates

Towards the end of 2009 the pound fell to a six month low of 1.0628 Euros. Figures released by the UK government suggested that demand was still low in the country. The pound was also under downward pressure because of the low value of the interest rate. A recent report suggested these would remain at their historic low of 0.5% until 2014. Business confidence in general remained frail and there was concern over when the UK economy would start to recover from its negative growth. There was huge excess capacity in the UK. In addition the government had a huge deficit which was expected to cause problems with cutbacks and tax increases in the future.

Questions

1. Explain what determines the value of a currency.

2. Analyze why the pound might have fallen so low towards the end of 2009.

3. Analyze the possible effects on the UK economy of a fall in the value of the currency.