TRADE AND EXCHANGE RATE VARIABILITY

Communication from the European Economic Community

The following communication has been received from the delegation of the European Economic Community.

Excessive and erratic variations in exchange rates entail increased cost to our economies and are at times the cause of considerable disturbances in international trade. The notion of "erratic and excessive variation" is not easy to define; it covers those variations which diverge sharply from the relative trend in the main economic indicators of the countries concerned.

The alarming feature of exchange rate behaviour in recent years is not so much the fact that exchange rate movements have been large and sudden, but that, on a number of occasions, they have been completely, or almost completely, reversed within quite short periods of time, for example:

The deutschmark

- appreciated against the dollar by 22 per cent between May 1978 and January 1980;
- depreciated against the dollar by 31 per cent between January 1980 and August 1981;
- appreciated against the dollar by 13 per cent between August and November 1981.

The yen

- depreciated against the dollar by 27 per cent between October 1978 and April 1980;
- appreciated against the dollar by 25 per cent between April 1980 and January 1981;
- depreciated against the dollar by 18 per cent between January 1981 and April 1982.
Sterling

- Depreciated against the deutschmark by 30 per cent between January 1976 and January 1979;
- Appreciated against the deutschmark by 33 per cent between January 1979 and February 1981;
- Depreciated against the deutschmark by 16 per cent between February and October 1981.

Examples would be cited of other currencies (e.g. Swiss franc) which have been affected by similar erratic movements.

It is possible to argue that in some or all of these cases the initial movement was towards a more appropriate equilibrium level, but in that case it would appear that either the original movement went too far, or its reversal was inappropriate. It cannot seriously be argued that an exchange rate of DM 1.70 to the dollar reflected the "fundamentals" in January 1980 and that one of DM 2.50 reflected them a year and a half later. Exchange rate movements on this scale, which bear little or no relation to changes in costs within the countries concerned, make it impossible for many enterprises in the country whose exchange rate has appreciated to export or compete with imports, at a profit. If the enterprises concerned are large, they may be able to finance the losses until such time as the exchange rate movement is reversed, whereupon there will be a return to profitability. Smaller enterprises, however, may not have the financial resources to absorb losses for more than a very short period of time, neither can they simply withdraw from the market when it becomes unprofitable and then re-enter it when a reversal of the exchange rate restores the scope for profitable trading. If an enterprise is to maintain the loyalty of its customers, it must be able to supply on a continuous basis, not merely from time to time, when the exchange rate climate is favourable.

There is thus clearly a danger that large swings in exchange rate will, in due course, exert an unfavourable effect on the volume of trade between the countries concerned and will encourage demands for protection. The tendency towards protectionism, in one form or another, must be brought under control.