South India Journal of Social Sciences, Vol. XXI No. 1

INTERNATIONAL CURRENCY EXCHANGE OF THE POUND AND ITS EFFECT ON THE UK

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INTRODUCTION

As this is very popular and people are very familiar, many people who begin trading foreign exchange (FOREX) usually select the pound sterling (GBP) as one of their trading currencies. Trading based on fundamentals (economic reports and news events) can help traders save plenty of time and provide direction on where to concentrate their efforts by letting them know which reports will be released next and which will have the biggest effects on the GBP.Having said that, this article will highlight a few economic reports that might be used by new traders as a starting point for their own research. The purpose of this essay is to investigate the impacts of the global exchange of British pounds.

Up until 2022-2023, it is predicted that the exchange rate between the pound and the dollar will decrease at a compound annual rate of 1.8%. In June 2016, the United Kingdom made the decision to exit the EU. Due to the decision and the overnight increase in market uncertainty, the pound sank sharply versus many significant foreign currencies, including the US dollar.For the first time since 1985-86, the average GBP-USD exchange rate fell below US$1.4000 throughout the course of a fiscal year. The GBP-USD exchange rate declined by 13.3% in 2016-17, with the average monthly return on £1 being US$1.3072. The exchange rate between the US dollar and the pound sterling has stayed low compared to the long-term average due to continuous economic turbulence and uncertainty. However, a number of factors combined in 2017-18 to drive up the USD-pound exchange rate.According to IBIS World(2022), for instance, the pound sterling's value against the US dollar increased in late 2017 and early 2018 as a result of an official agreement on the details of a transition period through December 2020 between the UK government and the European Commission (EC). This strengthening was aided by a rather strong UK economy under the then-prevailing market conditions, a continual stream of Brexit-related news stories, trader anxiety over the US Fed and potential interest rate hikes, and the then-prevailing market circumstances. The GBP/USD exchange rate increased the overall year 2017-18 by 1.5%, with the average annual return of £1 being US$1. 3271.

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One of the most internationally integrated economies is found in the English-speaking countries of Scotland, Wales, and Northern Ireland make up the United Kingdom. In 2020, the fifth-largest importer and exporter in the world were the United Kingdom. It also boasts the third- and fifth-largest foreign direct investments coming into and leaving the country. In 2020, commerce with the EU's 27 member states accounted for 52% of the UK's imports and 49% of its exports.This essay aims to analyze the international currency exchange rate of the pound and its effects on the UK's economy. By researching the impact of the UK's economy, it is found that the pound sterling is one of the currencies that is used most frequently in the foreign exchange (forex) market (GBP). The pound sterling, which has a long history and was the first currency to be actively traded on the foreign exchange market, serves as the country's official unit of account. Being one of the biggest forex hubs in the world adds to London's appeal.Since the GBP is popular and well-known among traders, many people who begin trading forex frequently select it as one of their trading currencies. Traders who base their judgments on the principles (economic reports and news events) can benefit from knowing which reports monitoring.

Before we begin, it is important to understand that the same basic economic factors often affect all currencies in different countries. The six factors that seem to have the most influence on all currencies are monetary policy, price inflation, investment, the UK export/ import market, economic growth (GDP), and balance of payment.

Why is the pound weak?

For most of 2022, the pound's value in relation to the dollar has been declining. Inflation in the UK has skyrocketed, and recession worries are intensifying. The pound fell to its lowest level against the dollar since the start of the pandemic when the Bank of England issued a warning in May about a slowdown in the UK economy. (When the UK decided to leave the EU in June 2016, it experienced its largest-ever one-day slump). Since the US dollar is by far the largest reserve currency for the world economy, it is comparatively appealing. To put it another way, it is the primary currency that nations hold in order to withstand economic shocks, pay for imports, and pay off debts.

Weak Pound- Higher Prices-

A depreciation reduces customers' real purchasing power in the affected economy. This is because when people travel abroad, imports become more expensive, ranging from imported food and petrol to currency value (Johnson, 2019). According to the consensus, retail prices in the UK are around 2% higher now (2019) than they would have been if the pound had not declined in 2016. Imports into the UK account for more than 40% of the annual GDP. Higher costs also have a disproportionate effect on lower-income households, which spend a larger share of their monthly budget on basics like food and fuel.

Upside to a weaker Currency-

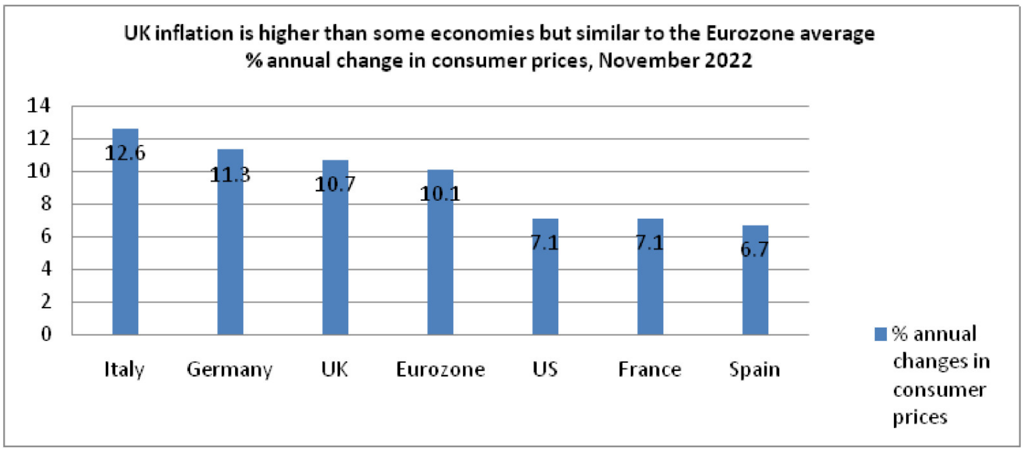
A lower currency, however, increases the real purchasing power of foreign tourists visiting the UK. The number of foreign tourists visiting the United Kingdom has increased increasing aggregate demand. A weaker currency improves the pricing competitiveness of UK exporters, providing that exporters choose to lower their foreign prices rather than simply accept a higher profit margin on each unit supplied.Increased export sales inject money into the circular flow of income and spending, which can have a positive multiplier effect on output, profitability, and planned capital investment.

Countries like China and Japan recognize the importance of exchange rates in economic success and strive to maintain their currencies low and competitive in order to promote their economies.

Rising Cost of Living in the UK

Since early 2021, the cost of living in the United Kingdom has been rising (as shown in figure 1). In October 2022, the annual rate of inflation hit 11.1%, a 41-year high, before falling to 10.7% in November 2022. The UK's annual inflation rate in November 2022 was 10.7%, which was higher than other comparable economies like France and the US (7.1%), but similar to the average for the Eurozone (10.1%) and Germany (11.3%). The affordability of home goods and services is influenced by inflationary pressures. This paper provides an overview of growing food, electricity, and gasoline prices, as well as the impact of the Ukrainian crisis(Harari, et al., 2022). It describes the government's assistance as well as how rising prices, interest rates, and other policies affect household budgets.

Figure 1



Sources: ONS, series D7G7 & Eurostat, HICP

Consumer goods, energy prices and food pushing inflation higher-

According to the Consumer Price Index (CPI), consumer prices were 10.7% higher in November 2022 than the previous year. Consumer goods price rises have contributed to rising inflation, owing to increased consumer demand and supply chain bottlenecks. Food prices have grown considerably in recent years as well. Another major cause of inflation is the rise in residential energy tariffs and fuel prices. Between November 2021 and November 2022, domestic gas prices increased by 129%, while domestic power expenses increased by 65%. Gas prices reached all-time highs after Russia launched a full-fledged invasion of Ukraine, and they will continue to rise during much of 2022 as a result of Russian supply restrictions. Electricity costs are linked to gas prices, and as a result, they have risen.

On September 8th, the Prime Minister announced a new energy price.On October 1, a guarantee would be implemented, capping normal usage at £2,500 per year. It was supposed to run for two years, but the Chancellor declared on October 17 that it would only last six months. In the Autumn Statement 2022, he stated that the EPG will be increased to £3,000 for typical yearly use in April 2023 and would last until the end of March 2024. Russia's invasion of Ukraine has global economic consequences on humanitarian, military, and political levels. As a result of the battle, higher energy costs have had a significant economic impact on the United Kingdom.

As a result, UK automobile fuel prices and household energy costs have soared. Business energy bills have also risen and are expected to rise more.The Energy Bill Relief Scheme, a new government support program for businesses, was unveiled on September 21.Russia and Ukraine are also major producers and exporters of agricultural items such as wheat and metals. Despite recent declines in global commodity prices, many products have grown more expensive in foreign markets, adding to increases in food and material prices in the UK.

Table 1: CPIH annual and monthly inflation rates by division

UK, November 2021, October 2022, and November 2022

	CPIH 12-month rate		CPIH 1-month rate	
	October 2022	**November 2022**	**November 2021**	**November 2022**
CPIH All items	9.6	9.3	0.6	0.4
Food and non-alcoholic beverages	16.4	16.5	1.0	1.1
Alcohol and tobacco	6.2	4.2	2.6	0.6
Clothing and footwear	8.5	7.5	1.1	0.1
Housing and household services	11.7	11.7	0.2	0.3

Of which owner occupiers' housing costs	3.6	3.7	0.3	0.4
Furniture and household goods	10.6	10.8	0.5	0.6
Health	4.2	4.7	0.0	0.6
Transport	9.3	7.6	1.7	0.1
Communication	3.2	2.5	-0.2	-0.8
Recreation and culture	5.9	5.3	1.1	0.6
Education	3.2	3.2	0.0	0.0
Restaurants and hotels	9.6	10.2	-0.3	0.4
Miscellaneous and goods and services	5.1	5.4	0.0	0.3
All goods	14.8	14.1	1.2	0.6
All services	5.3	5.4	0.1	0.2
CPIH ex food, energy, alcohol, and tobacco (core CPIH)	5.8	5.7	0.4	0.3

Source: Office for National Statistics- Consumer price inflation

Global inflation is increasing-

Since 2021, several countries' consumer price inflation has been rising.One significant factor is supply constraints induced by the pandemic. As the global economy recovers from the crisis, demand for products and commodities, particularly consumer goods, has increased. The Ukraine crisis is also driving up commodity prices, which is driving up worldwide inflation. The annual inflation rate in the United Kingdom in November 2022 was 10.7%, which was higher than in certain comparable economies such as France and the United States (7.1%) but comparable to the Eurozone average (10.1%) and Germany (11.3%).

Inflation is predicted to decrease in 2023-

Because the Government's Energy Price Guarantee (EPG) package limits household energy unit costs, inflation is likely to be lower than it would have been if Ofgem's domestic energy price ceiling had been in place (which was due to be higher than the EPG). According to the Office for Budget Responsibility (OBR), if the EPG had not been implemented, inflation would have peaked at 13.6% in early 2023, which is 2.5 percentage points higher than its projection with the EPG. In estimates released on November 17, 2022, the OBR predicted that CPI inflation would peak at 11.1% in Q4 2022. This is comparable to the Bank of England's expected peak of 10.9% in the fourth quarter of 2022.

Annual inflation is expected to slow in 2023, according to both the OBR and the Bank of England, because the substantial rises in energy prices observed in 2022 are eliminated from the annual comparison. The OBR estimates inflation to reduce to 3.8% by Q4 2023, although the Bank forecasts a rate of 5.2% for the same period, largely due to the expectation that domestic inflationary pressures "remain high".

Policies of the Government-

On September 8, the government announced the Energy Price Guarantee (EPG), which will cap the unit cost of energy. The quantity of energy used by a home will continue to determine its cost, although the government expects the average household to save £900 this winter.

In 2022/23, the EPG may cost the government some £25 billion, while a similar scheme for non-domestic energy customers (businesses, charities, the public sector, and so on) could cost an additional £18 billion.

Other government assistance proposed for 2022 include:

o £400 off energy bills for all households

o £650 payments to those receiving means-tested benefits.

Pensioners will receive an additional £300, while persons receiving disability benefits would receive an additional £150. There will also be a £150 council tax rebate for households in council tax categories A to D, a 5p cut in fuel price, and a rise in the amount someone can earn before paying National Insurance Contributions (NICs).

Literature Review-

To begin with,(Marshall, et al., 2018) in their article presented the original research on the Bristol Pound, a CLC based in the United Kingdom, and examine its impact (or lack thereof) on localization. In doing so, the authors investigated four study questions: (1) How far has the £B facilitated more local procurement by businesses that use it? (2) How far has the £B enabled more local production? (3) What are the barriers to localization, and are CLCs capable of overcoming them? (4) What additional options could be pursued if CLCs are not the answer to localization?

Overall, the data indicate that the £B is a poor instrument for localization. The £B has not inspired firms that use it to buy more local items; it has simply substituted the unit of account in which (some) local trade is priced. Furthermore, the £B has had no obvious influence on local productive capacity. These findings are significant since CLCs have been proposed as a potential technique for driving localization. This advocacy may be misguided.

Given the widespread national and worldwide interest in Brexit in recent years, it is critical to investigate the correlations between the Sterling Pound's exchange rates and a number of dependent factors(Mavragani, et al., 2020). In this regard, their paper first investigates the predictability of the Pound Euro and Pound Dollar exchange rates following the 2016 UK Referendum, in which Britons were asked to vote on whether or not they wanted the UK to remain in the EU, using Google Trends data on selected phrases and themes. The quantile dependence method of cross-quantilograms was used to uncover statistically significant quantile dependencies for data from March 2015 to February 2020 with lags ranging from zero to 30 months (in weeks).

In their study,Plakandaras, et al(2016)investigate the impact of Brexit on the considerable decline in the USD/GBP exchange rate. The dedicated Economic Policy Uncertainty index, which analyses the ratio of newspaper stories discussing Brexit, quantifies the economic uncertainty induced by the UK's decision to hold a referendum. They pick the models that best correspond to the evolution of the exchange rate based on an out-of-sample forecasting exercise after training both linear and nonlinear models on daily and monthly frequencies. Their empirical findings support the use of the uncertainty index to forecast exchange rate movements.

Teslya & Podolskaya(2020)conducted and presented the research. His article enabled authors to address two major concerns: When did the British pound lose its financial clout? And what caused this to occur?

Some experts argue that the pound sterling lost its dominance as the world's reserve currency in 1929, while others argue that it was surpassed by the US dollar much later, after World War II.They are unable to pinpoint the specific year, let alone the exact date when this occurred. A combination of various factors, in our judgment, has progressively contributed to this shift in currency positions.

According to Chu(2018), On the surface, the GBP depreciation induced by the United Kingdom Brexit has had a positive impact on exports, but in the current context of global trade, the idea of using expected exchange rate depreciation to increase export trade is a type of improper competitive strategy that can benefit oneself at the expense of others, and the active influence brought by such a strategy is merely a flash in the pan that cannot be sustained. To improve international trade conditions, it is asked to first improve its own industrial structures; second, it is asked to reduce trade protectionism and trade barrier establishment; and finally, it is asked to strengthen scientific technology research in order to lower goods production costs and even provide more competitive goods.

Chitu, et al(2012), argued in their article that the pound sterling remained the leading international currency during the interwar years and even for a brief period following World

War II. These scholars emphasized that one of the primary reasons for the change in sterling's standing in global finance is the rapid development of financial markets. The authors attempt to demonstrate that the US dollar was developing as the next dominant currency, so pushing the pound sterling to a lower place in significance, using data on the currency denomination of foreign public debt in 33 nations from 1914 to 1946.The conclusions reached by these academics allowed them to put some doubt on the three main concepts underlying foreign currencies in general.

First and foremost, they established that the pound sterling was surpassed by the dollar 15 years before the period indicated by other sources, namely 1929.Following that, Chitu, et al(2012), made the premise that losing a monetary leadership position is not necessarily permanent. They substantiated their claim by claiming that, while losing its supremacy in the late 1920s, the pound sterling recovered after 1933 and was actively utilized alongside the US dollar until the conclusion of the decade.

Finally, the analysts question the idea that there is only room for one dominating international currency. Using the Tobit model, the researchers obtained actual evidence demonstrating that their three assumptions on international currency patterns are true. Furthermore, they discovered a genuine explanation for why the role of the pound sterling has shifted in the world of finance. According to their findings, the rapid expansion of American financial markets was the true driving force that enabled the US dollar to seize the lead and drive the pound sterling from the first to the second preferred reserve currency.

A total of 185 academic, grey, and commercial papers were reviewed. The literature for review was chosen using a search approach that included Google and Google Scholar, as well as the JSTOR and Elsevier databases. In conjunction with DIT, search phrases were chosen to generate insight across the entire range of important themes.

The fundamental conclusion of this review is that in understanding the relationship between exchange rates and trade volumes, micro-level theories should be favored over macro-level theories. In general, the literature indicates a degree of separation between exchange rates and aggregate commerce, which appears to be mostly explained by micro-level factors. The divergence at the macro-level could potentially be attributed to the difficulty in assessing the links suggested by these theories due to complicating variables, rather than these ideas failing.

Nonetheless, the research shows that a greater emphasis should be placed on micro-level ideas, for which there is solid and consistent evidence in the literature. Macro-level theories should be accepted, but only for understanding the long-run relationship between exchange rates and trade, if there is some evidence that the predictions of these theories can hold over a longer time horizon.

Fluctuation in Currency And its effect on Trade of UK-

A currency has no intrinsic worth by itself. A twenty-pound note's worth only holds true for as long as its users agree that it is valuable as a unit of exchange. As opposed to this, metals like gold or silver have intrinsic worth. On a global scale, currencies are evaluated in relation to one another. One Euro will buy more Pounds, Sterling if the value of the pound sterling falls in relation to the Euro. This straightforward idea was the catalyst for and currently governs the global trade pattern. Although minor currency swings are rather frequent and occur often, they barely affect world trade during the course of the working day.Extreme volatility can occur in particular circumstances, which undoubtedly has an effect on trade.

Export/Import Market of UK-

The European Union is the UK's biggest trading partner overall. The great majority of EU countries use the Euro as their national currency and are members of the Eurozone. This is advantageous for the UK because a substantial portion of commerce just requires the study of the Pound Sterling to Euro currency connection. This generates a great deal of stability, which is a positive aspect of global trade.

The effects of a decline in the value of the pound sterling are quite easy to comprehend when looking at the link between the euro and sterling as an example. As a result, one pound sterling would now buy fewer euros, increasing the price of Eurozone goods for UK consumers and businesses. Imports would inevitably decline as a result, at least temporarily(Simplex Express Freight, 2022). One of the biggest worries about Brexit is that the value of the pound is in jeopardy due to economic unpredictability, given that the UK is a net importer.

On the other hand, a decline in the value of the pound would promote exports from the UK by making them more affordable. This would result in a rise in demand within the UK economy and promote GDP growth. In this scenario, inflationary pressures might also increase, and it would be necessary to manage this to maintain stability. Humans who have the capacity for rational thought make decisions. The overall trade patterns are only likely to change if a currency fluctuation boosts prices in a sustained manner over time. Although short-term shocks will be felt, they won't occur frequently enough to have a trade-altering effect.

Effects of a weak pound on investment-

Even though a decline in the value of the pound may seem unsettling, there are certain advantages. For UK companies who export goods abroad, a falling pound is great news because it makes those products more accessible to clients abroad. This could lead to an increase in sales. As almost 70% of the revenues of FTSE, there is a total of 100 companies that come from abroad, a weaker pound can also trigger a rise in the FTSE 100 Index.(RBC Brewin Dolphin, 2022). That income is primarily expressed in US dollars. These profits in dollars are more valuable when converted to sterling. when the value of the pound falls because it can be used to purchase more pounds.

On the other hand, a weak pound hurts UK importers and businesses with international supply networks. This is a result of the falling purchase power of their pounds. Additionally, inflation tends to increase in the UK since imports outpace exports. As a result, when the pound is lower, both companies and customers will pay more for goods. Anyone on a fixed income, including many elderly people or the purchasing power of workers who haven't received a wage increase in a while, will be particularly hard hit by inflation, which reduces their income's purchasing power and makes them poorer.

Effect on GDP/Economic Growth-

The general state of the UK economy is a factor that could have an impact on currency values is an important element.In the UK and many other countries, the gross domestic product (GDP) is the main measure of economic activity (GDP).The three different GDP reports-preliminary GDP, revised GDP, and final GDP-should be understood by traders(Nguyen, 2022). Because it gives traders a head starts on gauging the U.K.'s economic health, the preliminary GDP estimate is the first to be released and often has the biggest impact. The following Final GDP and revised GDP reports commonly make changes to the preliminary GDP, which is also the least accurate.

Due to the GDP being a quarterly report, retail sales, the manufacturing PMI, and the services PMI are a few additional measures of economic activity that many traders will also incorporate. Retail sales typically have a greater weighting of importance since consumers are frequently regarded as the engines of economic activity.

Price and Inflation-

Price and inflation, the first significant component, are essential to the value of the pound. High-inflation nations frequently have a faster rate of currency depreciation than other nations. In order to counteract these negative consequences, the central bank also routinely modifies interest rates in response to inflation. The Consumer Price Index (CPI), which is developed and released by the Office for National Statistics, is widely used by traders to calculate the UK inflation rate. The CPI determines whether consumer goods and service prices have gone up or down over a given period of time. This report is notable because it serves as the baseline for the Bank of England's (BOE) inflation target.

In addition, while changes in consumer prices frequently affect changes in the degree of inflation, alternate metrics like the Producer's Price Index (PPI) can be useful. Because it detects inflationary increases in raw materials before they may eventually reach the consumer level, as measured by the CPI, the PPI is frequently referred to as a leading indicator of inflation. In order to get a more complete picture, both reports should be compared because the PPI data is also made accessible earlier than the CPI.

Monetary Policy-

Bank of England's (BOE) monetary policy is another crucial factor. One of the BOE's primary objectives is to promote monetary stability, which it defines as "low inflation and confidence in the currency." If it becomes apparent that the pound's stability is in jeopardy, the BOE will use the tools of monetary policy at its disposal to restrict inflation. Traders make attempts to forecast when these monetary activities, such as adjustments to interest rates, will take place.

To stay informed on monetary policy, traders will keep an eye on fluctuations in bank rate, or the interest rate that the banks charge to other banks on deposits held with the BOE. The decisions for the rate of interest are made monthly by the Monetary Policy Committee (MPC), and you may view them on the Bank of England website. It is important to remember that if the MPC simply maintains the previous bank rate, there won't usually be any debate. However, the MPC will make a statement that is more intriguing and might offer signals as to what will happen next if the rate changes.

Balance of Payment-

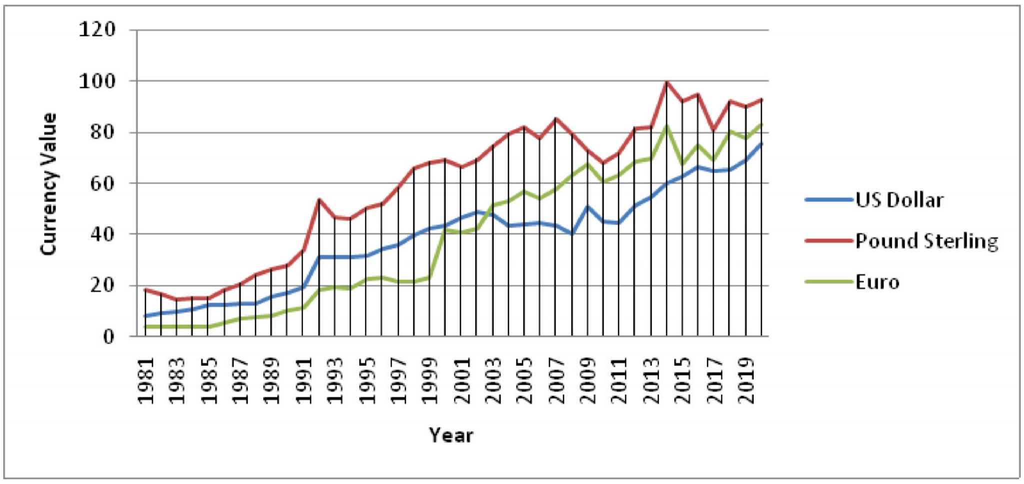
Last but not least, the balance of payments (Bop) of a country serves as a history of its dealings with the rest of the world. Despite having three accounts, the current account is the only one that typically matters to forex traders. As per, Nguyen(2022) the current account displays a country's export and import volumes as well as its income and transfer payment flows. A currency generally benefits from a current account surplus since it shows that more money is coming in than is leaving, whereas a currency suffers from a deficit for the exact opposite reasons.

It should be mentioned that the current account report is issued quarterly, but the trade balance report is released on a regular basis. If you only need information on import and export statistics, consult the trade balance report.

Comparison of the Exchange Rate of the Indian Rupee with the US Dollar, Pound

Sterling, and Euro from 1980-81 to 2019-20

Figure 2



Conclusion-

The UK economy is a highly developed, market-driven social market economy. Measured using nominal gross domestic output/product (GDP), purchasing power parity (PPP), and GDP per capita, it is the world's sixth-largest economy overall, accounting for 3.3% of global nominal GDP. With this research, it is found that inflation rises in the UK because imports outpace exports. As a result, when the pound is lower, both companies and customers will pay more for goods. Anyone on a fixed income, including many elderly people these workers, as well as those who have not received a wage raise in a while, will be particularly hard hit by inflation, which reduces their income's purchasing power and makes them poorer. Since the GDP is only released once every three months, many traders will also incorporate more frequent measures of economic activity, such as retail sales, manufacturing PMI, and services PMI. Retail sales normally carry a higher weighting of importance since consumers are typically thought of as the engines of economic activity.

The main objective of this paper is to study the impact of exchange rate fluctuations on UK exports, and the rising cost of living in the UK. The paper also depicts Fluctuations in Currency and their effect on Trade inthe UK under which the paper focused on the export/import market of the UK, the Effects of a weak pound on investment, Effects on GDP/Economic Growth, Price and inflation, Monetary Policy, Balance of Payments. By researching this, it is found that the fuel prices for UK vehicles and house energy bills have soared. Energy bills for businesses have also risen and are expected to rise further. On September 21, the Energy Bill Relief Scheme, a new government support program for businesses, was revealed.

Alternative metrics like the Producer's Price Index (PPI) can be useful even if changes in consumer prices frequently affect changes in the level of inflation. Because it detects inflationary increases in raw materials before they may eventually reach the consumer level, as measured by the CPI, the PPI is frequently referred to as a leading indicator of inflation. In order to get a more complete picture, both reports should be compared because the PPI data is also made accessible earlier than the CPI. Another important factor is the Bank of England's (BOE) monetary policy.Increasing monetary stability, which the BOE defines as "low inflation and confidence in the currency," is one of its primary objectives. If it appears that since the pound's stability is in jeopardy, the BOE will utilize the tools of monetary policy at its disposal to keep inflation under control.

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