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The impact of Currency Depreciation in Developing Countries

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Abstract-- *This paper is aimed at examining the economic effects of cpurrency depreciation in developing countries.The study will also focus on the Marshal-learner model which is an extension of the Marshal's model in examining whether a depreciation in the exchange rate is likely to cause a balance of trade (Carbaugh 435) especially in developing countries where it is common that the balance of trade is likely to deteriorate due to currency depreciation. The Marshal's model states that devaluation or depreciation of currency makes export relatively cheaper and import relatively expensive.*
Also, an increase in the demand for foreign goods in the home country increases the demand for foreign currency which causes depreciation as well as trade deficits adversely affecting developing economies. The study also analyses the reasons government resort to currency devaluation and its effects on the imports and exports in the home country.

Keywords--*Currency devaluation, currency depreciation, developing countries, Balance of trade.*

I INTRODUCTION

Currency depreciation can be described as the devaluation or loss of value of a given country's currency compared to one or more foreign money. Although the benefits of currencies do not remain the same all the time, depreciation in developing countries has far more reaching consequences in the economy. For instance, if the Ghana Cedi depreciates relative to the US dollar, the exchange rate (the Ghana Cedi price of dollars) rises- It will take more cedis to purchase 1 dollar (1 Dollar= 4.50 Cedis 1Dollar = 4.57 Cedis. Various governments have had to use currency devaluation for economic reasons such as increasing a country's balance of trade and making foreign goods less competitive in local markets. There are multiple causes of currency depreciation such as the increase and decrease in demand for the money about the supply. Demand increase occurs in the short run unpredictably due to resins, such as the balance of trade, speculations, among other factors that influence the international capital market. For instance, increased demand for foreign goods in a home country increases the need for foreign currency, which in turn cause a depreciation in home currency. The speculations can also cause depreciation that the money is either over-valued, which results in the changes in currency value. This study examines the economic effects of currency depreciation in developing countries**. The research question in the study is: what is the impact of currency depreciation in developing countries?**

Analysis: Trade is an essential element of economic growth and development. It should be noted that surpluses in trade bring an inflow into the economy, which in turn causes economic expansion. Trade policies are therefore discussed by various economists as well as policymakers in such countries to control trade and flow of goods(Macmillan Education 3). Currency exchange rate and balance of business are the most common

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issuessurroundingcurrency depreciation. Although there exists a theoretical development, researchers focus mainly on developed countries such as the United States leaving a knowledge gap in developing countries. There are various models applied in examining currency depreciation and its effect on economic growth such as Marshal-learner and J-Curve.

Marshal-learner model is applied to examine whether a depreciation in the exchange rate is likely to cause a balance of trade(Carbaugh 435). The model states that for a balance of business to improve, then the sum of long-term export demand as well as import demand elasticity must be greater than one. Considering developing countries where currency depreciates, it is common that the balance of trade is likely to deteriorate. Demand for imports is inelastic, which means that the demand for goods in the country does not reduce at first. After an extended period, people in such a country switch to low-cost products, especially those that were imported in the past.

Similarly, exports in developing countries become inelastic. The results of currency depreciation are that foreign market chooses products that are cheaper due to the devaluation. Thus, imported quantities increase the exported goods. The results of this effect are that there is a negative cost effect which floods the local markets.

On the other hand, J-Curve explains that devaluation increases the value of imports. In the long run, export volumes increases due to lower prices that are considered more competitive in the market. J-curve is a time series graph which examines the effects of currency depreciation on the balance of trade as well as equity return funds(Ferrara et al. 237).

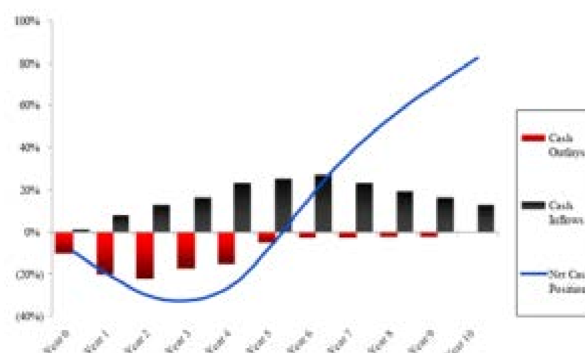

Figure 1:currency depreciation

Source: Wikimedia Commons.

Devaluation affects the value of goods on exports and imports, and when the cost of imported goods exceeds exports, then there exists a deficit. In other words, currency depreciation in developing countries causes trade deficits.

Various effects are resulting from the currency deficit in developing countries. Currency devaluation makes exports cheaper and increases the value of imports. Having trade deficits in developing countries leads to increased borrowings to finance its trade deficits. In other words devaluation exports and discourages imports and this causes competitiveness of the economy to increase. It should be noted that trade surplus boosts economic growth while shortages affect the growth(Macmillan Education 3). Growth domestic product is used to estimate the economic outputs in a country. In most developing countries, such as Ghana, leads to reduced jobs and decreased wages.

Another effect of imports is that it makes the developing countries to rely on developed nations for financial assistance. It also makes it possible for a government to be controlled by the superpowers both politically and for economic power. Dependency on another country for essential commodities such as food, oilas well as industrial materials makes it difficult for an economy to grow(Basar, and Pau 3). For instance, the United States suffered a recession one time when there was arestraint on exporting oil products by OPEC countries.

Additionally, developing countries with high imports compared to exports are forced to increase the foreign currency domestic researches to pay for the imported commodities.

II CONCLUSION

The increase in foreign currency reserves hurts the value of the local currency. In particular, the local currency value reduces, leading to negative economic issues such as inflation and increased interest rates. Inflation increases competition for local companies which are forced to competewith low priced imported goods. The result of such devaluation of the currency is that developing countries remain poor, unable to provide food for the population, and there are increased rates of unemployment.

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