What Moves Exchange Rates

Economics

The short-run and long-run drivers, which differ.

Short run

- Interest rate differentials
- Capital flows and sentiment
- Expectations of policy changes
- Risk appetite and safe havens
- Highly volatile

Long run

- Relative inflation rates
- Purchasing power parity tendency
- Productivity differences
- Persistent trade imbalances
- Slow and noisy convergence

THE DIFFERENCE THAT MATTERS

Purchasing power parity holds poorly in the short run and better over decades. It is a tendency, not a rule.

Higher domestic inflation erodes a currency over time. The Big Mac index is a rough popular test of the same idea.