Effects of a Currency Move

Economics

What a depreciation actually does, and how quickly.

A depreciation improves the trade balance only if demand is sufficiently elastic.

Marshall-Lerner: improves if PEDx + PEDm > 1

Immediately after The J-curve.	**Balance often worsens**
After 12-18 months Balance improves.	**Volumes adjust**
Inelastic demand	**May not improve at all**

THE COMMON MISTAKE

× Expecting an immediate improvement

✓ Volumes take time to respond

Contracts are already priced, so in the short run you pay more for the same imports before volumes shift.

Depreciation also imports inflation. It is a real income cut for domestic consumers, which is the cost of the competitiveness gain.