US dollar gains ground against the euro



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A snapshot from the news about the relationship between the US dollar and the euro, the two most important currencies in the world.

The US dollar is gaining ground against the euro because of the interest rate gap between the two economies.

The Federal Reserve, the US central bank, has been keeping the central interest rate quite high at around 3,50% - 3,75% for some time now and it is expected to rise further.



The European Central Bank (Eurozone) uses a central rate of 2,25%.

This interest rate gap (which is likely to rise) makes investing in dollars and US bonds relatively attractive, which supports the dollar's position.

The US dollar is therefore worth more against the euro.





INTERNATIONAL PAYMENTS

AN INTRODUCTION



International trade transactions are paid for with **currency**.

When importing, a country pays in foreign currency, namely the currency of the country where the goods and services are purchased. When exporting, a country is paid in its own currency.

The purchase of foreign currency is made on the **international exchange market.**

There, the dynamics of supply and demand result in a price: the **exchange rate.**

The value of each currency is therefore expressed in another currency.

Like the value of the US dollar is expressed in euros (and vice versa).

When the price of a currency increases, we speak of an **appreciation**.

If the price of a currency falls, we are dealing with a **depreciation**.



Fluctuations in the exchange rate can be explained by several factors:

- **Trade balance**: countries with a trade surplus see their currency appreciate because the demand for their currency increases, a trade deficit puts pressure on a country's currency and will depreciate the currency because the supply of the currency increases.

- **Interest rate gap:** if interest rates in one country are higher than interest rates in another country, the currency of the country with the higher interest rates will appreciate because that currency is more attractive to investors. The currency of the country with the lower interest rate will depreciate.



- **Inflation gap**: if inflation in one country is higher than inflation in another country, then the currency of the country with the higher inflation will depreciate because that currency falls in value. The currency of the country with the lower inflation rate will appreciate.

- **Speculation**: currencies are investment products, just like stocks. The expectation that a currency will appreciate attracts investors who speculate on exchange rate increases. In the opposite case, investors will dump a currency and thus speculate against the currency if there is an expectation that it will depreciate.

In principle, exchange rates can fluctuate freely. Then we talk about **floating exchange rates**, it is the most common system.

The disadvantage of this volatility is the **exchange rate risks.**

In a (less common) system of **stable or fixed exchange rates**, currencies are pegged to each other.

