2.2.5 Net trade (X-M)

a) *The main influences on the (net) trade balance:*
   - *Real income*
   - *Exchange rates*
   - *State of the world economy*
   - *Degree of protectionism*
   - *Non-price factors*

- Exports are goods or services that are produced in one country, then sold in another. Imports are goods and services brought into a country after being produced elsewhere
- Exports are the inflow of money, and imports are an outflow- so exports are an injection into the circular flow of income and imports are a withdrawal
- Net exports are the total money that flows into a country. If the amount spent on imports exceeds the amount received from exports (as it does in the UK), net exports will be a negative number
- Net exports tend to make up a small percentage of aggregate demand, so changes in net exports have a minor impact on AD
- Exchange rate: the price of one currency in term of another
- Factors causing changes in net exports:
  - **Real incomes:** if incomes rise within an economy, then there is a reduced incentive for domestic firms to export, because they can sell their goods and services in the domestic economy
  - **Change in exchange rate:** if the exchange rate rises, net exports are likely to fall as exports become less competitive abroad and imports become more competitive in the domestic economy. In the short term a strong exchange rate might increase the value of exports and decrease the value of imports, as spending patterns do not adjust quickly to price changes which is known as low price elasticity of demand for exports and imports. It causes the opposite reaction to AD than the one normally expected as people adjust their spending. Depreciation increases demand
  - **Competitiveness:** if a country's competitiveness declines, exports decline relative to imports
  - **Productivity:** more productive nations can produce more per person which gives them a comparative advantage
  - **Unit labour costs:** lower costs lower the price of exports increase demand for them
  - **Change in the state of the world economy:** The value of UK exports is highly dependent on growth rates in the rest of the world. The higher a country's real income, the more it tends to import so net exports fall. If export markets experience low growth than exports will decrease but if export market experience high growth, exports are likely to increase- improving net exports
  - **The degree of protectionism:** if there are high tariffs, quotas or other trade restrictions, then firms will find it difficult to export to certain countries. Tariffs cause domestic market to become inefficient and countries often respond with their own tariffs

- **Non-price factors:** Demand is also determined by things such as quality of engineering, reliability of after-sales service, advertising and transport costs
    - **Relative inflation:** a currency with higher inflation will depreciate against a currency with low inflation.
    - **Elasticity of demand (evaluation)**
- Economic policies affecting trade:
    - Demand management: tightening of fiscal policy which affects spending
    - Currency adjustment: manipulation of the exchange rate
    - Supply-side policies: policies which raise productivity and investment boosts productive capacity
    - Protectionism
- Export multiplier effect: many industries rely heavily on our key export industries remaining competitive