Exchange Rate Channel

Monetary policy affects net export through the impact of the interest rate on the exchange rate. Higher interest rates mean stronger currency, and stronger currency leads to a decline in net export demand and output. Conversely, lower interest rates weaken the domestic currency, while currency depreciation results in a rise in export and GDP. Interest rate changes also affect prices of imported goods and services leading to a direct price hike (with products that are exclusively or predominantly of imported origin) or indirect price hike (through the rise in costs of imported components in domestic products). **This is a very important channel in our country.**

The above monetary policy transmission channel can be illustrated as follows: