4.1.4 Terms of trade

- *Calculation of terms of trade*
- *Factors influencing a country's terms of trade*
- *Impact of changes in a country's terms of trade*

- Terms of trade index: price index of exports/ price index of imports
- Terms of trade: the ratio of the price of exports to the price of imports. Or, the amount of imports an economy can purchase per unit of exports
- A measure of trade competitiveness
- Factors influencing a country's terms of trade:
    - The country's rate of inflation relative to other countries
    - The country's productivity relative to that of other countries
    - Tariffs
    - The country's exchange rate
    - Globalisation has meant the price of goods has been impacted more so good importing countries have seen an improvement in their terms of trade
    - Prebisch-Signer hypothesis: over time, due to falling commodity prices in relation to manufactured goods, the terms of trade for developing countries has fallen. Globalisation has decreased the price of manufactured goods offsetting this.
    - The more inelastic the demand for exports than imports, the higher the terms of trade, since country can demand higher prices for its terms of trade
    - A country which only imports manufactured goods and exports primary goods has a worse terms of trade
- Impact of an increase in the terms of trade:
    - Improved living standards due to a reduction in the general price level
    - Cheaper imported technology
    - Deterioration in the balance of payments makes exports less competitive
- Zambia's pattern of trade is based on copper so its terms of trade are effected significantly by the world price of copper
- A current account deficit drains foreign exchange reserves
- Patterns of trade affect terms of trade