International business

International business Currency Exchange: Floating Rate Vs. Fixed Rate The global financial crisis is probably the main trend in development of the modern economic environment. A lot of experts claim that imbalances in international area and countries’ balances of payments were among the main reasons for the crisis. It is a well-known fact that exchange rate fluctuations may seriously affect balance of payments of a country. That is why a lot of attention is paid to the choice of exchange rate regime, especially in the developing countries.

Exchange rate can be considered as reflection of a national economy’s performance. In fact, it is a rate at which currency of one country is exchanged for another. Generally, correspondences between currencies, exchange rate reflect correspondence between two national economies. That is why it is not surprising that exchange rate is sometimes called a temperature of a national economy.

Generally, there are two types of exchange rate regime – fixed exchange rates and floating exchange rates. According to the fixed exchange rate regime, monetary authorities set some particular exchange rate, which does not change because of the market conditions. This opinion can be proved by the following words.

“ A set price will be determined against a major world currency (usually the U. S. dollar, but also other major currencies such as the euro, the yen or a basket of currencies). In order to maintain the local exchange rate, the central bank buys and sells its own currency on the foreign exchange market in return for the currency to which it is pegged” (Currency Exchange: Floating Rate Vs. Fixed Rate).

Under the floating exchange rate regime, exchange rate of a particular

currency is determined by the market forces. The exchange rate is set by relation between supply and demand for this currency. Central bank of a country cannot influence the market in order to affect the exchange rate.

It is quite difficult to say which exchange rate is better. The final choice depends on the particular macroeconomic conditions, international conjuncture, instruments of macroeconomic policy, particular period of time, etc. Therefore, opinions of experts have been divided in this context. Generally different periods in history were characterized with the different exchange rate regimes.

Under the gold standard the currencies of all the countries were linked to gold. It was a period of the fixed exchange rate regime – from 1870 to 1914. The regime was quite affective, but growing imbalances in international economy, lack of stocks of gold have ruined the regime.

After the World War II the currencies were pegged to the U. S. dollar. As a result the exchange rate regime was fixed again. However, some fluctuations were allowed. Governments had to manage currency market and overall situation.

In the end, that exchange rate regime has not created expected stability. As a result, almost all the countries in the world have been moving towards the floating regime. It is believed that this regime better reflects correspondence in international economy. Some countries use intermediate pegged regime. The developing countries, for instance, used fixed regime in order to fight macroeconomic problems – for example, inflation.

References

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