International Monetary System

Present International Monetary system (1972-present), Part A

Exchange Rate System after 1973

- The collapse of Bretton Woods System of exchange rate, the Board of Governors of the IMF appointed committee to suggest guidelines for evolving an exchange rate system that could be acceptable to the member countries

Exchange Rate System after 1973

- Flexible Exchange rates were declared acceptable to IMF members
- Central Banks were allowed to intervene in the exchange rate markets to iron out unwarranted volatilities
- Gold was abandoned as an International Reserve Asset
- The currencies are no longer backed by Gold

Flexible Exchange rates

- The system of Flexible exchange was abandoned by the Floating Exchange Rate system involves market forces determining the exchange rates:

- Its Merits are:

A. Exchange rates are automatically adjusted to changes in macro economic variables

B. Exchange rate is almost stable around the equilibrium in the long Run

C. Currency remains insulated from the shocks emanating abroad

Exchange Rate Regime

- No country in the world has adopted freely floating exchange rate system
- Within the exchange rate regime there are categories:
- Floating
- Pegging
- Traget Zone Arrangements

Floating Exchange Rate Regime

- This Regime consists:

A. Independent Floating System

B. Managed Floating System

Independent Floating Rate Regime

- Independent floating system does not involve intervention
- This is why independent floating is often termed clean Floating
- In Practice, intervention is found also in the case of Independent floating

Independent Floating Rate Regime

- In Independent Floating, the purpose of intervention is simply to moderate the exchange rate and prevent any undue fluctuation

- But no attempt is undertaken to achieve/maintain a particular rate

Managed Floating System

- Floating is generally managed in the sense that the system of managed floating involves direct or indirect intervention by the monetary authorities of the country to stabilise the exchange rate
- When the monetary authority stabilise the exchange rate through changing the interest rates, it is indirect intervention

Managed Floating System

- In case of direct intervention, on the other hand, the monetary authorities purchase and sell foreign currency in the domestic market
- Managed floating is also known as "Dirty Floating"
- The IMF called this practice a "Managed Floating with no predetermined path for the exchange rate

To be Continued…

Thank You