DOWNLOAD PDF EXCHANGE RATE REGIMES

Chapter 1 : Main Types of Foreign Exchange Rates

An exchange rate regime is the system that a country's monetary authority, -generally the central bank-, adopts to establish the exchange rate of its own currency against other currencies.

Extreme short-term moves can result in intervention by central banks, even in a floating rate environment. Fixed Exchange Rates Currency prices can be determined in two ways: As mentioned above, the floating rate is usually determined by the private market through supply and demand. Therefore, if the demand for the currency is high, the value will increase. This, in turn, will make imported goods cheaper. The rate is set against another major world currency such as the U. To maintain its exchange rate, the government will buy and sell its own currency against the currency to which it is pegged on the forex market. Some countries that choose to peg their currencies to the U. But in reality, currencies are rarely wholly fixed or floating because market pressures can influence exchange rates. A total of 44 countries met, with attendees limited to the Allies in World War II, which had not yet ended. The first large crack in the system appeared in , with a run on gold and an attack on the British pound that led to a President Richard Nixon took the United States off the gold standard in By late , the system had collapsed, and participating currencies were allowed to float freely. Central Bank Intervention In floating exchange rate systems, central banks buy or sell their local currencies to adjust the exchange rate. This can be aimed at stabilizing a volatile market or achieving a major change in the rate. Groups of central banks, such as those of the G-7 nations Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States , often work together in coordinated interventions to increase the impact. An intervention is often short-term and does not always succeed. A prominent example of a failed intervention took place in , when financier George Soros spearheaded an attack on the British pound. Soros believed that the pound had entered at an excessively high rate, and he mounted a concerted attack on the currency. The failed intervention cost the U.

Chapter 2 : Finance & Development, December - Choosing an Exchange Rate Regime

An exchange-rate regime is the way an authority manages its currency in relation to other currencies and the foreign exchange blog.quintoapp.com is closely related to monetary policy and the two are generally dependent on many of the same factors.

Monetary Union or Currency Union Several countries share a common currency. Examples are the eurozone current and Latin and Scandinavian monetary unions defunct Currency Board An institutional arrangement to issue a local currency backed by a foreign one. Hong Kong is a prime example. This imposes fiscal discipline, but the HKMA may not act as a lender of last resort, unlike a central bank. There is no legislative commitment to parity and there is a discretionary foreign exchange reserve target. Examples are Argentina, Venezuela and Russia. Examples here include the Slovak Republic and Syria. Exchange rates would be adjusted to keep pace with inflation rates and prevent a run on U. An active crawl entailed announcing the exchange rate in advance and implementing changes in steps, in an effort to manipulate inflation expectations. Other examples include China and Iran. Fixed Parity with Crawling Band A fixed parity arrangement with greater flexibility to allow exit from fixed parity or afford the monetary authority greater latitude in policy execution. Managed Float or Dirty Float A nation follows a policy of loose intervention to achieve full employment or price stability with an implicit invitation to other countries with which it conducts business to respond in kind. Independent Float or Floating Exchange Exchange rates are subject to market forces. The monetary authority may intervene to achieve or maintain price stability. Examples are the U. Flexible Currency Regimes Currency regimes may be both formal and informal. The former entails a treaty and conditions for membership in them. These were conditions of the Maastricht Treaty of during the long march to the ultimate formation of the euro. The currency peg system is somewhat less formal. Indeed, the aforementioned regimes form a continuum and monetary authorities have made policy decisions that could fall into more than one of these categories regime change. Think of the mids Plaza Accord taken to lower the U. This is conduct atypical of a free-floating currency regime. Currency regimes have formed to facilitate trade and investment, manage hyperinflation or form political unions. With a common currency, ideally, member nations sacrifice independent monetary policy in favor of a commitment to overall price stability. Political and fiscal union are typically prerequisites to successful monetary union where, for example, olive oil is manufactured in Greece and shipped to Ireland without the need for importers or exporters to employ hedges to lock in favorable exchange rates to control business costs. While the unending to-and-fro of European Monetary Union plays out on a daily basis, the history of currency regimes has been a checkered one, marked by both success and failure. A brief history of the more noteworthy ones, dissolved and extant, follows. Latin Monetary Union LMU A mid-nineteenth century attempt at monetary union, the effort involved France, Belgium, Switzerland and Italy being tethered to the French franc, which was convertible into silver and gold tender a bimetallic standard that was a common medium of exchange across the participating nations that maintained their respective currencies at parity with one another. The union ultimately encompassed eighteen countries. However, by World War I, the union was effectively finished. Scandinavian Monetary Union SMU First Sweden and Denmark, then Norway shortly thereafter, entered into a monetary union around with the ultimate goal of forming a political and economic partnership. To avoid the failure of the LMU, all three ended up being exchangeable into a fixed amount of gold. After about three decades, this union, too, unraveled when Norway declared political independence from Sweden and Denmark adopted more restrictive capital controls. With the advent of the First World War, each of the three members adopted their own monetary and fiscal policies, as there lacked a binding agreement to coordinate monetary and fiscal policies. In effect since , several countries that were former French colonies in central and West Africa are pegged to the French treasury, formerly via the French franc, now by the euro. Belgium and Luxembourg Each country maintains its own currency, but both currencies serve as legal tender in either country. The Belgian Central Bank runs monetary policy for both countries. This union has been in effect since Implications Though bound in some form by a fixed rate or common monetary unit, the economies of the individual members of a currency regime are a function of their local politics and economic policy. Some nations bear less sovereign debt than others bear and may be called upon to support the weaker members. Overall, such disparity does not bode well for the currency unit that reflects the mixed complexion of what may appear to be at times a currency disunion. A disconnect between common monetary and localized fiscal policies could put pressure on a regional currency bloc, driving down the value of the monetary unit. This occurrence could bode well for exporters, assuming robust trade environment. A deeper study of them will help investors understand their impact on risk management and asset allocation decisions in the portfolio management process. Trading Center Want to learn how to invest? 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exchange rate regimes in the world. The global monetary system: Injured reserve. Jul 15th , from Free exchange. A change in the rules of the global financial system is long overdue.

Forextraders Brought to you by: The foreign exchange market has gone through several major transitions over the years, moving through prolonged periods of fixed and floating exchange rate systems Most forex traders these days are very familiar with the currently popular system of floating exchange rates. Nevertheless, exchange rates among the major currencies were fixed or pegged for many years and were even tied to the price of valuable commodities like gold. Read more about trading pegged currencies. Dollar, which in turn had its price fixed relative to the price of gold. Currencies also generally kept their value over time, although devaluations were permitted in times of economic hardship. Nevertheless, speculative pressures built up and started hoarding gold, so in , U. President Richard Nixon acted to suspend the convertibility of the U. This unilateral move effectively took the Dollar off of the Gold Standard and eventually led to the downfall of the Bretton Woods system of fixed exchange rates. Bretton Woods was subsequently replaced with a system of floating exchange rates that prevails to the modern era for the currencies of most developed countries, and the period since is sometimes known as the Washington Consensus. Modern Exchange Rate Regimes Currently, most governments use one of three different exchange rate systems: Managed Floating Exchange Rate â€" This is the system that most developed nations use. In this system, the currency is allowed to float against all other currencies thereby letting market forces determine the value of the currency. The central bank may however step in to intervene in the currency markets or with interest rate changes to prevent extreme or unwanted movements. Pegged Exchange Rate â€" This system involves a country fixing their exchange rate to another currency, usually that of a major trading partner. For example, the Chinese Yuan is currently pegged to the U. Dollar, so when the Dollar moves, the Yuan will move along with it. This allows the currency more stability than a free floating exchange rate, and in the case of China, it allows the central bank to keep its currency at an artificially low value. Dollarization â€" Often used by developing countries, this system means a country uses a foreign currency like the U. Dollar instead of issuing its own currency. While this system provides currency stability, it impedes the country from developing its own monetary policy. Before , the Dollar had been a representative or commodity currency, backed by the value of gold. Fiat money has no intrinsic value other than the creditworthiness of the issuer and is only a promise by the issuer to pay back debts. As a result, the value of the Dollar fluctuates considerably as the fortunes of the United States change in the perceptions of the forex market. Learn about why currencies trade against the dollar. Trading Foreign Exchange on margin carries a high level of risk and may not be suitable for all investors. The possibility exists that you could lose more than your initial deposit. The high degree of leverage can work against you as well as for you. Was this article helpful?

Chapter 4 : List of countries by exchange rate regime | Revolvy

No legal tender of their own US dollar as legal tender. British Virgin Islands Ecuador El Salvador Marshall Islands Micronesia Palau Timor-Leste Turks and Caicos Islands.

Should countries fix, float, or choose something in between? But because countries no longer are obligated to peg their exchange rates in a system overseen by the IMF, they need a sound basis for selecting the regime best suited to their needsâ€”be it fixed, floating, or intermediate. Evolving views In practice, the preferred exchange rate regime, particularly for developing and emerging market economies, has evolved considerably over the past couple of decades. Pegging the exchange rate to a strong anchor currency often the dollar or the deutsche mark was popular in the early sâ€"especially for nations in transition from command to market economies that were seeking to stabilize their economies after their initial price liberalizations. But the s also saw a spate of capital account crises in emerging market countries, with sharp reversals of capital inflows leading to collapsing currencies and underscoring the fragility of such fixed exchange rate regimes. This so-called bipolar prescription, intended primarily for emerging market and developing countries, was much the same choice that the advanced economies were making. Many of those advanced economies were headed toward hard pegs in the form of a monetary union, while others were free floating. Some, indeed, managed to do both: The bipolar prescription for emerging market countries proved short lived, however. Fear of floating The review used a de facto classification of exchange rate regimes that was based on the actual behavior of the exchange rate rather than on what formal, or de jure, commitment the central bank had made. The review found that pegged exchange rates provided little benefit to emerging market countries in terms of either inflation or growth performance. Because such regimes are associated with greater likelihood of currency or financial crises, the review concluded that emerging market countriesâ€"and developing countries as they became more financially integratedâ€"should adopt freely floating exchange rates. But in practice, few central banks were or are, for that matter willing to follow such a policy of benign neglect because they cannot be indifferent to the value of their currency. When the value of the currency declines, authorities worry about both imported inflation and the balance sheet effects of an exchange rate depreciation on borrowers that have borrowed in foreign currency and suddenly find that debt more expensive to service. This fear of floating, as it has been called, is particularly prevalent among emerging market and developing countries for which sharp appreciations or depreciations of the exchange rateâ€"or, more generally, currency volatilityâ€"may be particularly deleterious. But it is also noteworthy that among advanced economies, euro area members avoid currency volatility by maintaining irrevocably fixed exchange rates through the monetary union with the countries with which they have the deepest economic ties, such as trade. So which regime should a country adopt? It was clearly time for a fresh look at this question. What they do and what they promise to do The just-completed review, based on a data set of IMF member countries over the period â€", is the most comprehensive study of exchange rate regimes. Not only does this study examine the impact of the exchange rate regime on a wider range of variables monetary and fiscal policies, inflation, output growth and volatility, cross-border trade and capital flows, crisis susceptibility, and external adjustment than did the earlier reviews, it is also the first to use both de jure what they promise to do and de facto what they do classifications of the exchange rate regime in its analysis. As a result, the message about the relative merits of various exchange rate regimes is more nuanced than those in the earlier reviews. Inflation performance There is ample evidence that, for developing and emerging market countries, pegged exchange rate regimes are associated with the best inflation performance. The only exception occurs when the peg is at an undervalued rate and the country is unable to offset the growth of the money supply that occurs when persistent current account surpluses and resulting accumulation of foreign reserves translate into excessive monetary growth; in such cases a small minority in the IMF data set , the inflation benefit from pegs does not occur. The inflation benefit from pegged regimes may seem at odds with the findings of the study, which found that emerging economies captured little inflation benefit from pegging. In nearly every case in which the central bank makes a formal commitment to a pegged exchange rate regime, it in fact maintains that peg. In other words, when it comes to pegging the exchange rate, deeds nearly always back words. The opposite caseâ€”a de facto peg without a de jure commitmentâ€”is much more common but does not deliver the same benefit in terms of anchoring inflation expectations and reducing inflation. By using both de jure and de facto classifications, the study was able to pick up on such subtleties, which were missed in earlier reviews. How growth fares Growth performance is best under intermediate exchange rate regimesâ€”those that maintain relatively rigid exchange rates but do not formally peg to a single anchor currency. This is largely because such intermediate regimes represent a happy balance between pegs and free floats. Pegged regimes are associated with lower inflation, lower nominal and real exchange rate volatility, and greater trade opennessâ€”all of which are associated with faster growth. But pegged regimes are also more susceptible to exchange rate overvaluation, which hurts competitiveness and undermines growth performance. Compared with pegged regimes, floating exchange rates are at less risk for overvaluation, but they also fail to deliver low inflation, reduced volatility, or better trade integration. Between these extremes, intermediate regimes achieve the best balance and are associated with faster per capita output growth of about half a percentage point a year after taking into account other factors that affect growth. Pegged exchange rate regimes are associated with better growth performance than floating regimesâ€”but only if they are able to avoid real exchange rate overvaluation and loss of competitiveness. Trade links That countries in a monetary union have deeper trade links is well known. But the study establishes that similar benefits for trade integration derive from simple pegs and, to a lesser degree, even from intermediate regimes. The study also finds thatâ€”crises asideâ€”capital flows under pegged and intermediate regimes tend to be more consistent with consumption smoothing than capital flows under floats. Indeed, promoting greater trade and cross-border investment was the economic motivation behind fixed exchange rates and eventual monetary union in Europe. Some trade-offs Nothing is perfect, of course. The study found three major downsides to more rigid pegged or intermediate exchange rate regimes. First, such regimes especially pegs severely constrain the use of other macroeconomic policies. What is striking in the study is that this constraint seems to hold, even for countries with less-open capital accounts or those that heavily sterilize reserve flows under pegs. The other striking result is that countercyclical fiscal policyâ€”cutting taxes and increasing government spending to counter economic downturns and vice versaâ€—is also heavily constrained under pegged exchange rate regimes. This presumably happens because capital flows are related to the business cycle in most emerging market and developing countries. Because expansionary fiscal policy in a downturn could lead to a loss of confidence and trigger further capital outflows, which would threaten the viability of the peg, there is less scope for countercyclical fiscal policy in countries with pegs. Thus, while pegging the exchange rate provides a useful commitment device for the central bank to anchor expectations by disciplining policies, it also limits the potential to respond to macroeconomic shocks. Second, both the and studies found that pegged and intermediate regimes are associated with greater susceptibility to currency and financial crises, such as debt crises, a sudden stop in capital inflows, or banking crises. The current study confirms these results, especially for developing and emerging market countries with more open capital accounts. But it also finds that credit booms, including those that end in crisis, are about as likely to occur under floating regimes as they are under pegged or intermediate regimes. Likewise, the study finds that the risk of a growth crisis a sharp decline in growth for whatever reason is not correlated with the exchange rate regime. Thus, greater crisis susceptibility is a cost of more rigid exchange rate regimes. But countries with floating regimes are not entirely immuneâ€”as indeed the current global crisis, with its epicenter in countries with floating regimes, has amply demonstrated. Third, pegged and intermediate exchange rate regimes impede timely external adjustment. On the deficit side, more rigid regimes are associated with larger deficits that unwind more abruptly and, because the real exchange rate does not adjust, have a greater impact on output and economic activity than deficits under floating regimes. On the surplus side, these regimes are associated with large and highly persistent surpluses that, if large enough in the aggregate, can affect the stability of the overall international monetary system. The bottom line Unlike previous reviews, the current study finds important trade-offs in the choice of exchange rate regimes. Regimes that are more rigid help countries anchor inflation expectations, sustain output growth, and foster deeper economic integration. But they also constrain the use of macroeconomic policies, increase vulnerability to crisis, and impede external adjustment. This trade-off is illustrated by the recent experience of European emerging market countries. Although many of the countries with less flexible regimes enjoyed strong growth in the years leading up to the present crisis, they also built up large external imbalances, increasing their vulnerability to abrupt and disruptive adjustment and limiting their potential for countercyclical macroeconomic policies. References Ghosh, Atish R. National Bureau of Economic Research. Choices and Consequences Cambridge, Massachusetts:

Chapter 5 : Exchange Rate Regime - Fixed and Floating exchange rate regimes | Economy Watch

In case of the fixed exchange rate regimes or the pegged exchange rate, as it is also known, the rates are meant to be converting directly to some other currency. At times, in case of the pegged exchange rate, the currency may be attached to a group of currencies or even precious metals like gold.

In the Bretton Woods system: This system aimed both to avoid the undue volatility thought to characterize floating exchange rates and to prevent competitive depreciations, while permitting enough flexibility to adjust to fundamental disequilibrium under international supervision; private capital flows were expected to play only a limited role in financing payments imbalances, and widespread use of controls would prevent instability in such flows; temporary official financing of payments imbalances, mainly through the IMF, would smooth the adjustment process and avoid unduly sharp correction of current account imbalances, with their repercussions on trade flows, output, and employment. In the current system, exchange rates among the major currencies principally the U. Some medium-sized industrial countries also have market-determined floating rate regimes, while others have adopted harder pegs, including some European countries outside the euro area. Developing and transition economies have a wide variety of exchange rate arrangements, with a tendency for many but by no means all countries to move toward increased exchange rate flexibility Figure 2. This variety of exchange rate regimes exists in an environment with the following characteristics: The growth of international capital flows and globalization of financial markets has also been spurred by the revolution in telecommunications and information technology, which has dramatically lowered transaction costs in financial markets and further promoted the liberalization and deregulation of international financial transactions; international private capital flows finance substantial current account imbalances, but the changes in these flows appear also sometimes to be a cause of macroeconomic disturbances or an important channel through which they are transmitted to the international system; developing and transition countries have been increasingly drawn into the integrating world economy, in terms of both their trade in goods and services and of financial transactions. Lessons from the recent crises in emerging markets are that for such countries with important linkages to global capital markets, the requirements for sustaining pegged exchange rate regimes have become more demanding as a result of the increased mobility of capital. Therefore, regimes that allow substantial exchange rate flexibility are probably desirable unless the exchange rate is firmly fixed through a currency board, unification with another currency, or the adoption of another currency as the domestic currency dollarization. Flexible exchange rates among the major industrial country currencies seem likely to remain a key feature of the system. Many medium-sized industrial countries, and developing and transition economies, in an environment of increasing capital market integration, may also continue to maintain market-determined floating rates, although more countries could may adopt harder pegs over the longer term. Thus, prospects are that: The approach taken by the IMF continues to be to advise member countries on the implications of adopting different exchange rate regimes, to consider the choice of regime to be a matter for each country to decide and to provide policy advice that is consistent with the maintenance of the chosen regime Box 1. Exchange Rate Regimes for Major Currencies Over the past two decades, exchange rates among the major currenciesâ€"the U. Views on whether, how, and to what extent it might be desirable to attempt to stabilize the exchange rates of major industrial countries differ widely. They range from advocacy of pure floating, a view espoused especially by those who believe that exchange rates always reflect fundamentals and that governments and central banks do not possess knowledge superior to that of the market in such matters, to proposals for the introduction of a single world currency. Intermediate proposals include target zones, a quasi-fixed exchange rate regime among the major currencies to be achieved by monetary policy rules aimed at the exchange rate, and various schemes for policy coordination that would take the exchange rate into account. There are two basic objections under current circumstances to any scheme that would attempt to achieve substantial fixity of exchange rates among the euro, yen, and dollar: Indeed, the fact that movements of exchange rates among the major currencies have, on many occasions, reflected divergences in cyclical positions among the countries concerned and in the stances of monetary policy needed to achieve price stability and to support growth indicates that this concern is warranted; second, the three major-currency areas do not conform to the usual criteria for an optimum currency area. The past decade has highlighted their lack of synchronization in economic activity and there is no reason to believe that differences across them would not continue to prevail in the future. Exchange Rate Regimes of Medium-Sized Industrial Countries Pegged exchange rate regimes have been extensively used over the past quarter century by medium-sized industrial countries, most notably in the exchange rate mechanism ERM of the European Monetary System. A number of other medium-sized industrial countries have successfully maintained floating exchange rate regimes over long periods, accepting that rates will move regularly and sometimes quite substantially in response to market forces. In the absence of an exchange rate peg, these countries have needed to establish an alternative nominal anchor for their monetary policies through a credible commitment to low inflation, which has in some cases been facilitated by an inflation target and operational independence for the central bank. Exchange Rate Arrangements of Developing and Transition Countries There is considerable diversity in the exchange rate regimes of developing and transition countries, from very hard currency pegs to relatively free floats and with many variations in between. This is not surprising in view of the wide differences among these countries in economic and financial circumstances. However, as these countries have adapted to expanding opportunities arising from deeper involvement in an increasingly integrated global economy and to changes in their own economic situations, there has been a shift toward greater flexibility, for the following reasons: Countries with single-currency pegs are exposed to the wide fluctuations among major currencies. In considering this conclusion, it is important to stress a critical caveat: And factors other than the relative fixity of their exchange rate regimes were, of course, at the root of the problems of the most affected countries. In particular, Russia and Brazil had serious fiscal problems, while Asian crisis countries had weak financial and corporate sectors. The following conditions are likely to favor the adoption by a country of some form of pegged exchange rate regime: When these criteria are applied, one group of countries for which pegged exchange rates would seem to remain sensible are small economies with a dominant trading partner that pursues a reasonably stable monetary policy, including small Caribbean and Pacific island economies, and the CFA franc zone countries. For such countries, there is generally little point in incurring the costs of attempting to run an independent monetary policy. Some important regional groups of emerging market economiesâ€"including the ASEAN and Mercosur countriesâ€"are in the situation of having both diversified linkages to the industrial countries and significant intraregional trade. One option to address this problem is to consider some form of regional monetary and exchange rate arrangement. However, neither of these groups presently has the institutional structures or the political consensus needed for regional economic integration, including for monetary and exchange rate policies, of the kind that took many years to develop in Europe. For the nearer term, less formal mechanisms for coordinating exchange rate policies may be feasible. Pegged exchange rate regimes imply an explicit or implicit commitment by the policy authorities to limit the extent of fluctuation of the exchange rate to a degree that provides a meaningful nominal anchor for private expectations about the behavior of the exchange rate and the requisite supporting monetary policy. The hardest form of a pegged exchange rate regime is a currency board, under which monetary policy is entirely subordinated to the exchange rate regime Box 2. Such an arrangement leaves no room for adjustments in the real exchange rate through changes in the nominal exchange rate. Accordingly, adjustments to changing conditions must be made by other means, including through domestic prices and costs, and economic activity and employment. Under all exchange rate regimes other than absolutely free floating, ancillary policy to affect the foreign exchange market through official intervention and controls merits attention. The key point is that benign neglect of the exchange rate is unlikely to be desirable. When the foreign exchange market is thin and dominated by a relatively small number of agents, it is likely that the exchange rate will be volatile if the authorities do not provide some guidance and support. This problem is compounded if there is no long track record of stable macroeconomic policies that can firmly anchor market expectations. Thus in practice, even developing and transition countries that maintain relatively flexible exchange rate regimes typically use both monetary policy and official intervention to influence the exchange rate. Intervention is generally more effective in countries where access to international capital markets is limited so that the authorities have greater capacity to influence conditions in the foreign exchange market by directly buying or selling foreign exchange. IMF Advice on Exchange Rate Policy In recent years, some observers have criticized the IMF for unduly favoring fixed exchange rates, others because it has appeared to show an inordinate fondness for currency devaluation, and yet others because it has appeared to have no principles guiding its advice on exchange rate regimes. The usual approach taken by the IMF is to advise member countries on the implications of adopting different exchange rate regimes, to consider the choice of regime to be a matter for each member country, and to tailor its overall policy advice to the regime chosen in each case. Discussions about the appropriate exchange rate policy and regime, and, issues relating to exchange restrictions may be important and, at times, central aspects of program negotiations and surveillance discussions. In fact, since providing this type of advice is at the core of IMF responsibilities, attention is paid to the sustainability of the exchange rate policy followed in countries where the authorities are committed to defend a particular path for the exchange rate, as well as to the possibility of misalignments of the exchange rate in countries that let the exchange rate float. In recent years, in addition to traditional domestic and external sector indicatorsâ€”such as the fiscal deficit, monetary or domestic credit growth, the real exchange rate, international reserves and the current accountâ€”increasing attention has been paid to indicators for the financial sector and the capital account. In the case of IMF-supported programs, the Fund lends to a country defending a peg or some other type of exchange rate commitment only if its assessment is that such a policy is sustainable, under the programs, although there have been cases in which pegs subsequently had to be abandoned, typically in the context of policy slippages. Currency Boards Currency board arrangements are the strongest form of exchange rate peg, short of a currency union or outright dollarization. A currency board is committed to supplying or redeeming its monetary liabilities at a fixed exchange rate, which implies that it must hold foreign reserves at least equal to its total monetary liabilities. Moreover, these are the only terms under which a currency board can exchange monetary liabilities; that is, in its pure form, a currency board cannot extend credit. Under these conditions, even short-term interest rates become completely independent of the will of the domestic monetary authorities: The key conditions for the successful operation of a currency board, in addition to the usual conditions deemed desirable for a fixed exchange rate regime, are a sound banking system, because the monetary authorities cannot extend credit to banks experiencing difficulties; and a prudent fiscal policy, owing to the prohibition of central bank lending to the government. The advantages of such a system include the credibility of the economic policy regime. Such credibility results from the high political cost of altering the exchange rate. In the past, boards have often been adopted by small open economies wishing to curb inflation; experience has shown that they can facilitate disinflation in larger economies as well. The costs of such a system include the absence of central bank monetary operations to smooth out very short-term interest rate volatility and the absence of a lender of last resort. Indeed, countries with this arrangement have experienced banking collapses, leading some of them to establish limited lender-of-last-resort facilities. Finally, the absence of domestic credit by the central bank implies that seigniorage is lower than under a normal peg. The main differences between a currency board and outright dollarization are that in the former case the country retains its national currency and hence seigniorage, whereas in the latter case seigniorage goes to the country of the anchor currency unless special arrangements are made; and that dollarization represents an even more complete renouncement of sovereignty.

Chapter 6 : Exchange-rate regime - Wikipedia

Trends in distribution of EM exchange rate regimes Ghosh, Ostry & Qureshi, , "Exchange Rate Management and Crisis Susceptibility: A Reassessment," IMF ARC, Nov.

Chapter 7 : List of countries by exchange rate regime - Wikipedia

An empirical study of exchange rate regimes based on data compiled from member countries of the International Monetary Fund over the past thirty years. Few topics in international economics are as controversial as the choice of an *exchange rate regime.*

Chapter 8 : Exchange Rate Regimes in an Increasingly Integrated World Economy -- An IMF Issues Brief

Modern Exchange Rate Regimes Currently, most governments use one of three different exchange rate systems: Managed Floating Exchange Rate - This is the system that most developed nations use.

Chapter 9 : A Primer On Currency Regimes

I. Overview The exchange rate regimes adopted by countries in today's international monetary and financial system, and the system itself, are profoundly different from those envisaged at the meeting at Bretton Woods establishing the IMF and the World Bank.