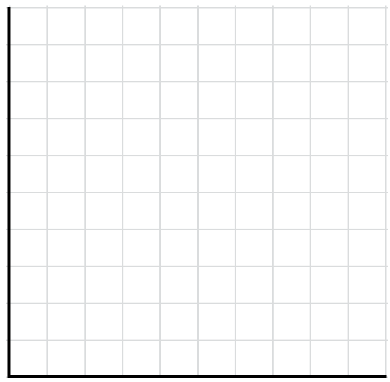
CONCEPT: FIXED AND FLOATING EXCHANGE RATES

● ***Exchange Rates*** determine how much of a ___________ currency you can get for your domestic currency

□ ***Floating Exchange Rate*** – a country that allows its exchange rate to be determined by supply and demand

> A floating exchange rate is also called a ____________ exchange rate



□ ***Fixed Exchange Rate*** – agreements between countries to hold exchange rates constant

> The ***gold standard*** was a fixed exchange rate system

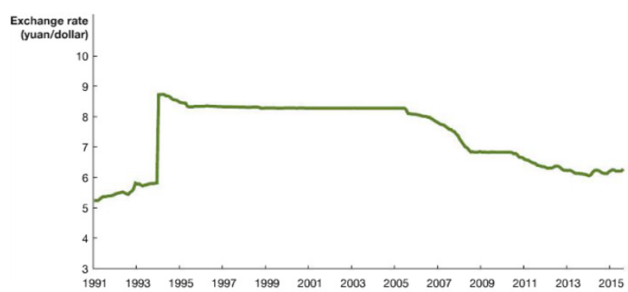
- Exchange rates were determined by the relative amount of gold in each country

- The gold standard was abandoned by most countries in the 1930s

> ***Pegging*** – when a country fixes the exchange rate between its currency and another (typically the USD)

- China pegged its currency to the USD for a long time, trading consistently at 8.28 yuan per USD

- In recent years, China has loosened its policy and more closely resembled a floating currency



□ ***Managed Float*** – when government participates in keeping stability in its floating currency

> The forces of supply and demand are still at play

> The government intervenes on occasion by buying or selling its own currency (affecting S&D)

> Most countries use a managed float system