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Ans-4 Discuss in details about Exchange rate and its determination.

Ans-4 In a liberalised and globalised world, various countries employ different methods to fix their currency's exchange rates. The determination of the exchange rate in a free market is a nation's private policy.

Despite a globalised world with free and fair trade agreements, there is no singal and universal currency. It is stumbling block for all nations which are engaged in buying and selling goods and services. Exchange rates were introduced in the second half of the 20th - century post the second World War.

* Exchange rate regimes :-

Since each country is free to determine its currency exchange policy, there are several different regimes of exchange rates. Countries with open markets like USA are prone to have an exchange rate that is free and unbound. On the other hand, closeted economies like China have tight control over exchange rates.

Between those polar opposites are hybrid regimes where the exchange rates may be harnessed on occasion by nation's Government and Central Bank. India follows hybrid regime,

It is determined by following Exchange rates :-

1). Floating Exchange rate :- A floating rates is also known as fluctuating or flexible exchange regime. It is determined only by prevailing market forces. Any Currency which is dependent on a floating regime is also called a floating Currency. One good example of a floating exchange currency is the US dollar.

Many economists tend to side with floating exchange rates. They feel that the market should determine a Currency's Value and free-market forces should not be manipulated. For example, if the prices of crude oil go up, the prices of USDs tend to fall. There is an inverse relation between these prices.

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Since, oil price of vary daily, the USD value fluctuates freely.

2). Fixed exchange rates :- This is sometimes called a pegged exchange rate System because the Governments tend to keep a tight leash on exchange rates. In these regimes, the currency value is fixed, or pegged, against certain foreign Currencies - either individually or a basket - or against its reserves of gold and foreign Currencies.

Perhaps the most famous example of a fixed exchange regime is China. In this regime, market forces are not solely relied upon to fix exchange rates. Instead, the Country's Central Banks will sell or buy reserves to set exchange rates when forex markets are fluctuating widely.

3). Pegged Float Exchange Rate :- This system includes 3 different and hybrid regimes. Foreign exchange rates are determined mostly by existing market forces, but Governments and Central Banks Can step in to throttle their Currency's exchange rates.

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The 3 types are :-

- Crawling Bands :- Here, the Central Bank of a Country will permit fluctuations till a Specific range, which is usually pre-determined. Once that band is breached, the concerned authorities will step in.

- Crawling Pegs :- Under this System, the Central Bank will allow gradual appreciation or depreciation of its currency on the international market. If there are any market uncertainties, this regime will allow the currency to "glide".

- Horizontally pegged Bands :- It is Some What similiar to crawling bands. However, the currency is allowed by Central Banks to fluctuate much more freely - provided the exchange rate does not breach 1% of it's currency's gross Value.