Exchange Rate Systems

Economics

Floating, fixed and managed, and the trade-off each accepts.

Floating

- Set by the market
- Absorbs external shocks
- Monetary policy stays independent
- Volatile, complicating trade
- No reserves needed to defend

Fixed

- Pegged to a currency or basket
- Certainty for traders and investors
- Monetary policy tied to the anchor
- Requires reserves to defend
- Vulnerable to speculative attack

THE DIFFERENCE THAT MATTERS

The impossible trinity: fixed rate, free capital flows and independent monetary policy — choose two.

Educational reference. Managed floats sit between the two and are the most common arrangement in practice.