Exchange rate regimes=>

- Fixed exchange rate – HK$, CHF
- Floating exchange rate – US, Japan, Euro
- Intermediary regimes
  - Fixed with periodic adjustments (China)
  - Managed float (US, Japan, etc. at times)
  - Trading band or target zone (Singapore)

How to fix rate=>

❖ If fixed rate is ABOVE market equilibrium, i.e. price floor => $Q_S > Q_D$ => surplus
<e.g., Thai government wants THB @ B25/$ but market equilibrium is B30/$>

- FX intervention => CB buys THB vs. US$
  - Depletes FX reserves
  - Equiv. to capital inflow on the Financial Account
- Change S&D conditions => raise interest rates => D↑/S↓
- Impose capital control => prevent residents from moving money offshore => S↓

❖ If fixed rate is BELOW market equilibrium, i.e. price ceiling => $Q_D > Q_S$ => shortage
<e.g., Chinese gov wants RMB @ ¥6.5/$ but market equilibrium is ¥5.5/$>

- FX intervention => CB sells RMB vs. US$
  - Accumulates FX reserves
  - Equiv. to capital outflow on the Financial Account
- Change S&D conditions => lower interest rates => D↓/S↑
- Impose capital control => prevent foreigners from moving money onshore => D↓

Pros/cons of fixed exchange rates =>

❖ Pros
  - Certainty about future value of XΔ rate => increased two ways trade (important for countries with higher percentage of trade/GDP
  - Commitment to maintaining low and stable inflation

❖ Cons
  - Monetary policy cannot be used to manage domestic AD => loss of sovereignty
  - Cost of carrying FX reserves (China!)
  - Capital controls => black market, red tape, etc. + distortions