from policymakers. They don't have to always alert to the exchange rate in order to correct the system by policy

Disadvantages of free-floating exchange rate

1. Unstable exchange rates
- If the demand and supply of the currency are inelastic, greater the change in exchange rate

2. Speculation
- Speculation will tend to be an inherent part of a floating system and it can be damaging and destabilising for the economy, as the speculative flows may often differ from the underlying pattern of trade flows.

3. Uncertainty for traders and investors
- The uncertainty caused by currency fluctuations can discourage international trade and investment→make them difficult to plan

4. Lack of discipline on the domestic economy
- Government may pursue irresponsibly inflationary policies for short-term political gain. They will have adverse effects over the longer term as the government will at some point have to deflate the economy again, with a resulting fall in output and rise in unemployment

Advantages of fixed exchange rate

1. Certainty
- With fixed exchange rates, international trade and investment become much less risky since profits are not affected by movements in the exchange rate

2. Little or no speculation
- Provided the rate is absolutely fixed and people believe that it will remain so there is no point in speculating

3. Prevent governments pursuing 'irresponsible' macroeconomic policies
- As some governments give some irresponsible policy in favor of next election

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Disadvantages of fixed exchange rate

1. Competitive contractionary policies leading to world depression
- Conflicts with other macroeconomic objectives as government/central banks use reserves to remain fixed exchange rate, it will reduce government expenditure and increase unemployment. It cause recession and restriction on economic growth

2. Problems of international liquidity
- Government/Central Bank stabilizes the currency by involving drawing from reserve account in order to cushion the effect of currency fluctuation→↑withdrawal money→liquidity problem

3. Inability to adjust to shocks
- Less Flexibility. It is difficult to respond to temporary shocks.

4. Speculation
- If speculators believe that a fixed rate simply cannot be maintained, speculation is likely to be massive. For example if there is a large balance of payments deficit, speculating selling will worsen the deficit as government have to use reserve to stabilize the currency and may force devaluation and leading a disaster