

CH. 6 FOREIGN EXCHANGE RATE

❖ Foreign Exchange

- Foreign exchange refers to foreign currency or all currencies other than the domestic currency. For example, US Dollar, British pound etc. are foreign exchange from the view point of India.

❖ Foreign Exchange Rate

- The rate at which currency of one country can be exchange for the currency of the other country is called the rate of foreign exchange.(For eg. \$1 = Rs.45)

✚ System or Types of Exchange Rates

There are two broad concepts:

(A)Fixed Exchange Rate System

❖ Meaning

- It is the rate which is officially fixed by the government or financial authority of the country.
- In other words it is the rate which is officially determined in terms of gold or any other currency by the government.

But under fixed exchange rate system basically there are two concepts.

✓ Gold Standard System:

In this system each and every country is to measure its currency in the terms of gold / was to define its value of currency in terms of gold . By considering gold value of each country exchange rate could be determined .

Example

If \$1 = 200 gm of gold

Rs. 50 = 200 gm of gold = \$1=Rs. 50

Now if it change

\$1 = 200 gm of gold

Rs. 70 = 200 gm of gold = \$1= Rs. 70

✓ Adjustable Peg System (Bretton wood System)

Under this system :

- a. Different currencies were pegged to one currency i.e. US\$
- b. US\$ was assigned gold value at a fixed price .
- c. Value of one currency in terms of US\$ becomes a value of that currency in terms of gold .
- d. Gold continued to be the ultimate unit of parity.

❖ Merits

(i) Stability