**PREP3: Exchange Rate Systems**

**THIS HOMEWORK REQUIRES YOU TO RESEARCH THE INTERNET AND I HAVE NOT (on purpose) GIVEN YOU SPECIFIC SOURCES TO READ. THERE ARE 3 TASKS TO COMPLETE. DUE FOR TUESDAY 7th MAY at 1315**

**RECAPPING Exchange Rate Systems**

Exchange rate systems are ways in which Government’s manage their currency on the world stage. There are essentially two categories of system:

1. **Floating Exchange Rate –** is one where there is NO Government intervention and currencies are allowed to be determined by the forces of supply and demand on the FOREX (foreign exchange markets). Therefore currency values are determined by speculation by currency traders in the short run, to trade and investment requirements in the longer turn and (arguably) by inflation levels in different countries in the very long run.
2. **Fixed Exchange Rate –** is one where a currency has a fixed value against another currency (or commodity).
   1. **Fully fixed -** The best example is the ‘Gold Standard’ (see below) where countries made their currency fixed to a certain amount of gold.
   2. **Managed Exchange Rate (‘Semi Fixed’) –** are where Government’s allow the currency to float on the FOREX markets but will intervene perhaps to keep it in a narrow band in an ‘adjustable peg’ system (see Bretton Woods below) or in a ‘dirty float’ system where the Government might intervene intermittently into the FOREX markets to smooth day to day volatility. Sometimes, managed exchange rate systems are still considered ‘fixed’; for example, the ‘adjustable peg’ system is fixed within a threshold rather than to a specific weight of gold (like the gold standard example).

**UK History of Exchange Rate Systems**

**TASK 1: Using the internet, research both the ‘Gold Standard’ or ‘Bretton Woods’ and then add to the two boxes below, ready to discuss your findings with others in the class next week.**

**1816 - 1914: ‘Gold Standard’ (fully fixed)**

Sterling was worth a fixed amount compared to other currencies and gold itself. In order to ensure that Sterling maintained its value, the BoE was obliged to exchange gold for pounds at the specified rate.

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| ***RESEARCH (delete this writing in the box to start writing your own notes – I have started you off with some basic questions below)*** *How did it work?**Why was it successful?**Why was it not successful?* |

**1914-1944: Years of War**

The Gold Standard was abandoned at the start of the First World War in 1914 but a new standard was attempted in 1925 when the pound was fixed at the pre-war value. However this approach was abandoned in 1931 due to the Great Depression and sterling suffered a 25% devaluation as a result. It was left to the ‘free foreign exchange markets’ to set the currency until 1944.

**1944 - 1971: ‘Bretton Woods System’ (semi-fixed)**

A system of currencies, pegged to the Dollar (which itself was fixed to the price of gold at $35 an ounce).

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| ***RESEARCH (delete this writing in the box to start writing your own notes – I have started you off with some basic questions below)*** *How did it work?**Why was it successful?**Why was it not successful?* |

**1971 - 1990: Floating exchange rate**

See class notes on how exchange rates are determined.

**1990 - 1992: ‘Exchange Rate Mechanism’ (ERM) – (semi fixed)**

A semi-fixed exchange rate where Sterling was pegged to the German Deutsch Mark. We will watch a video in class and discuss this SO NO NEED TO COMPLETE THIS BOX FOR HOMEWORK – we will fill in the box below in class. But more tasks to do on the next page…

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**1992 – Present: Floating exchange rate**

See class notes on how exchange rates are determined

PLEASE TURN OVER – There are more tasks to complete for your PREP HWK

**Other Countries and their Systems: The ‘Dollar Peg’**

**TASK 2:** Please research the recent controversy of China pegging their currency to the US dollar.

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| ***RESEARCH (delete this writing in the box to start writing your own notes – I have started you off with some basic questions below)*** Why did they do this and why was it so controversial? |

**Evaluating Currency Intervention and Managed Exchange Rate Systems (Fixed and Semi-Fixed)**

**TASK3: Complete this table after reading different sources on the internet**

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| --- | --- |
| ADVANTAGES | DISADVANTAGES |
|  |  |
| CONCLUSION | |