$$\int.$$

Flexible
or
Floating

Revaluation/Devaluation

done

central Bank

under
fixed
ex.
rate

∟   X   (+)

∟   M   (−)

∟   BoT   (+)

∟   GDP   (+)

∟   Emp   (+)

∟   Inflation (+)

(ii) **Flexible/Floating Ex. Rate**

    (a) Under this system, the exchange rate is determined by the market forces of demand & supply.

    (b) The exchange rate under this system may keep changing.

    (c) Speculation takes place in the

forex market.

(d) Hedging is also done
     by the people.
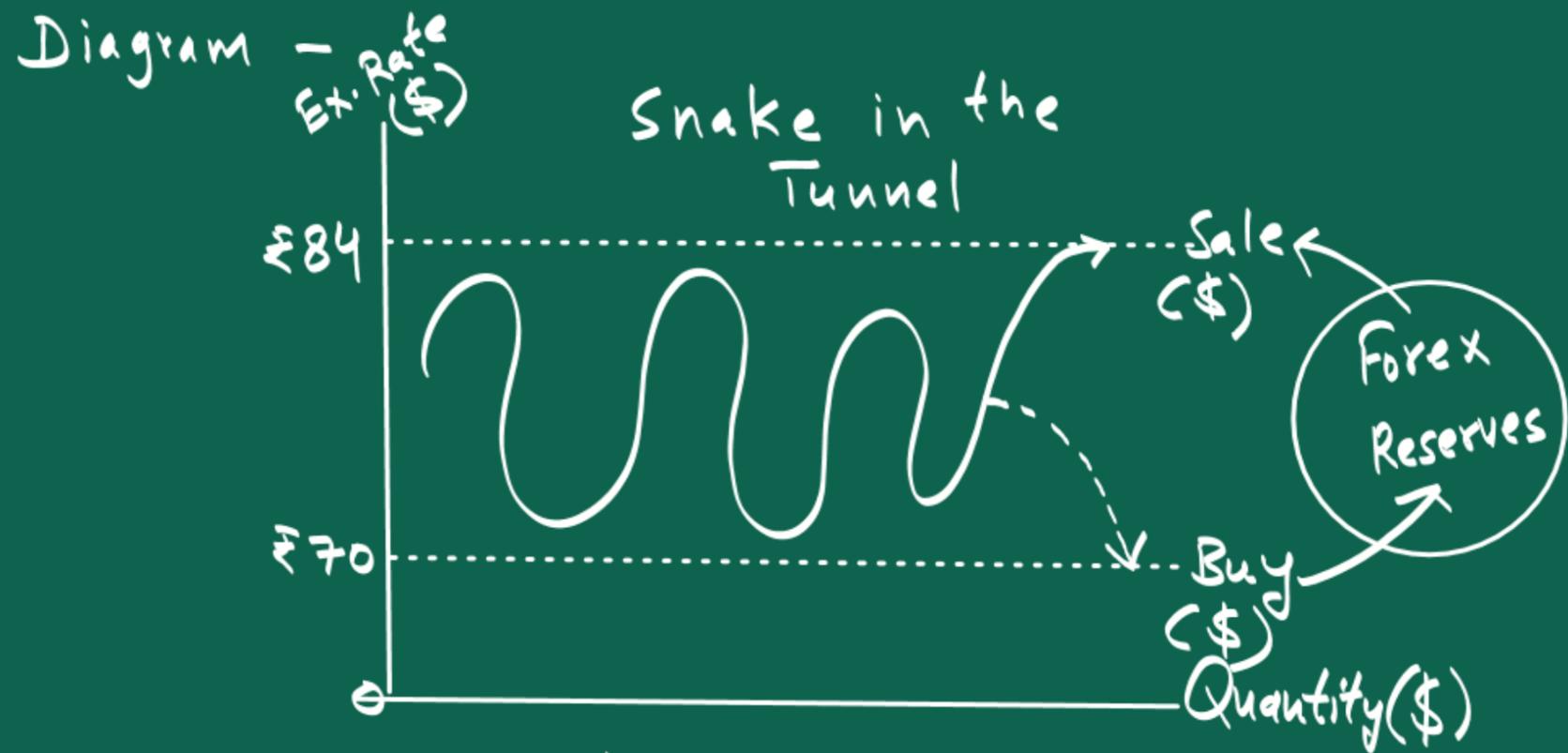
(iii)   Managed Flexible/Floating
Exchange Rate

or

Dirty Float

↓

This is also the present
exchange rate system being followed
in India since March 1993.

Under it, the exchange rate is flexible but the central bank makes direct or indirect intervention in the forex market.

Under it, the exchange rate is maintained within a range.

Diagram —

Ext. Rate ($)

Snake in the Tunnel

₹84 ········· → Sale ($)

Forex Reserves

₹70 ······ Buy ($)

Quantity ($)

(i) RBI buys $

(ii) Money supply — ↑ ⟶ ↑ Prices

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(iii) Sterilisation → Bonds are sold through OMO.

↓

This will neutralise increase in money supply

Depreciation (domestic Currency)

$\downarrow$

Automatic decrease in the value of the domestic currency in terms of a foreign Currency.

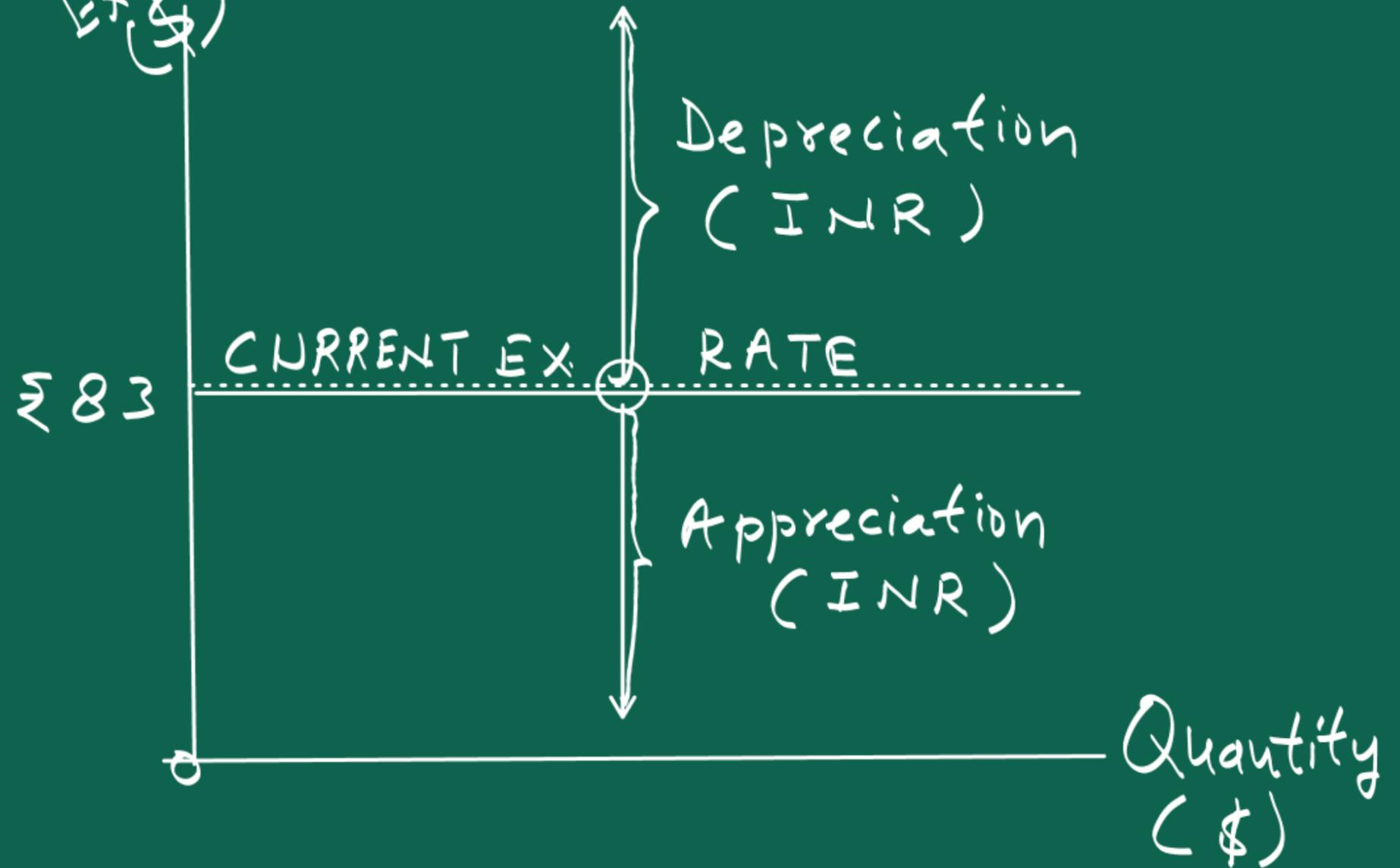Note : The impacts of depreciation and devaluation will be the same.

Appreciation (domestic currency)

↓

Automatic increase in the value of domestic currency in terms of a foreign currency.

Note : The impacts of revaluation & appreciation will be the same.

Diagram —

Ex. Rate
($)

Depreciation
(INR)

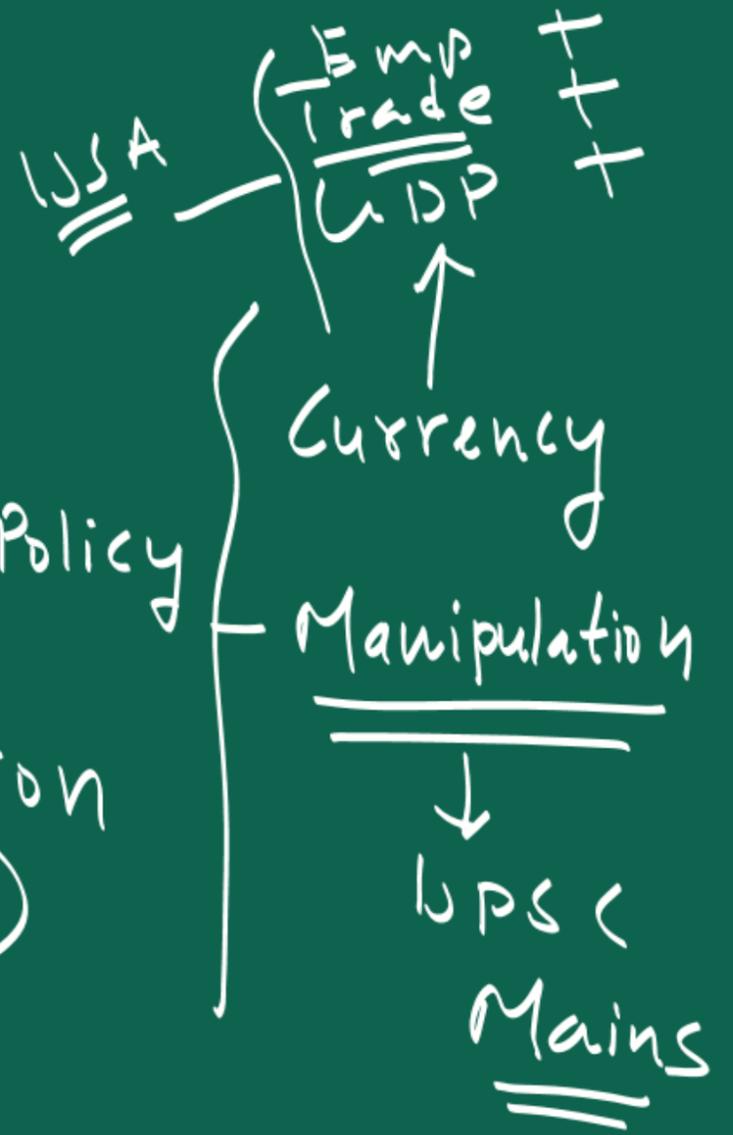₹83 ···· CURRENT EX ⊙ RATE ····

Appreciation
(INR)

Quantity
($)

Monetary Policy (USA)
&
Impact on Indian Rupee

Hawkish
Monetary Policy
↓
Depreciation
(INR)

Dovish
Monetary Policy
↓
Appreciation
(INR)

USA { Emp
      Trade ++
      ———
      GDP } ↑

Currency

Manipulation
═══════
↓
UPSC
Mains

NEER REER

(i) Meaning —

The exchange rate of a basket of currencies.
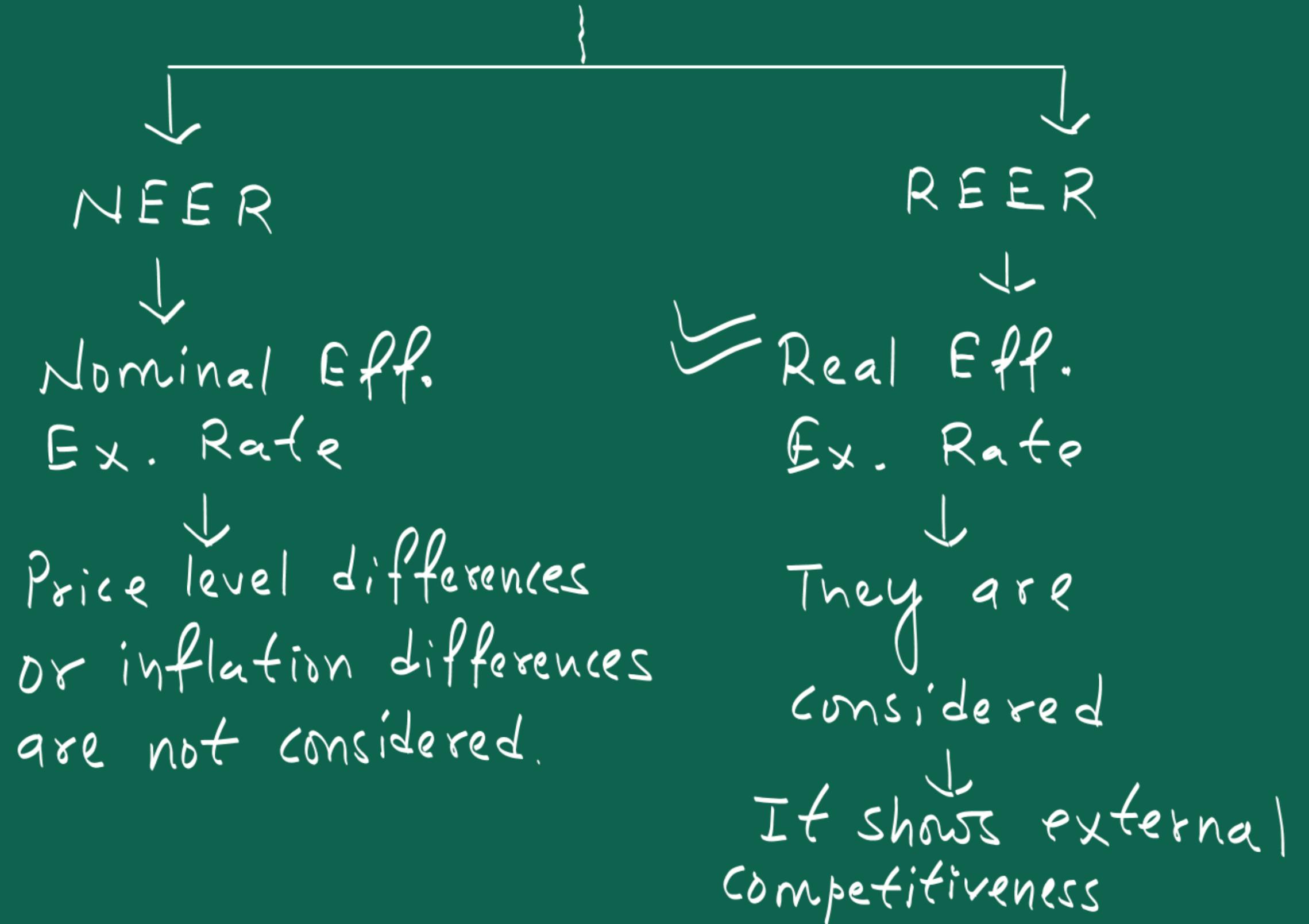
$\downarrow$

₹ 80 ⟶
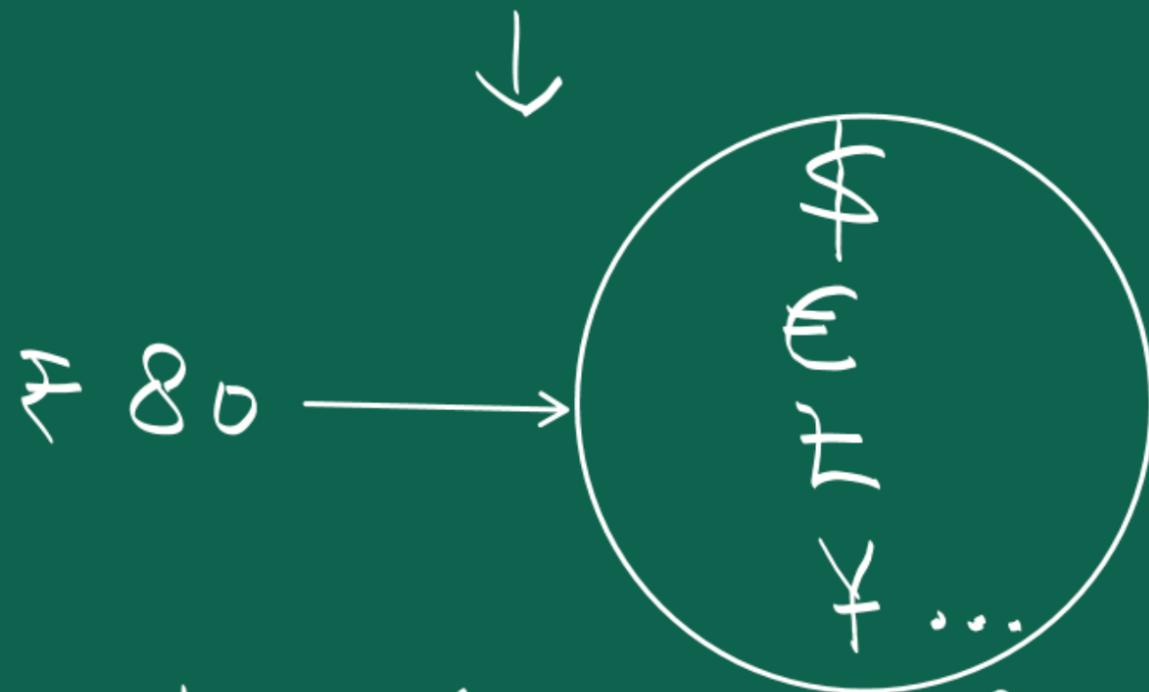
$\$$
$€$
$£$
$¥$ ...

The above is the effective exchange

rate of foreign currencies expressed in the domestic currency.

From the above, we can also know the effective exchange rate of Indian Rupee as follows —

$$\left(\frac{1}{80}\right)$$

(ii)   Types

```
                    ┌──────────────┴──────────────┐
                    ↓                              ↓
                  NEER                           REER
                    ↓                              ↓
              Nominal Eff.                  ✓ Real Eff.
              Ex. Rate                        Ex. Rate
                    ↓                              ↓
         Price level differences            They are
         or inflation differences           considered
         are not considered.                    ↓
                                            It shows external
                                            Competitiveness
```

(iii) How to know REER – <u><u>INR</u></u>

$\downarrow$

$$(REER)_{INR} = (NFER)_{INR} \times \dfrac{P}{Pf}$$

Here –

P = Domestic Price level

Pf = foreign Price level

(iv)

Currency baskets
being used in India
{

6- Currency
Basket

40- Currency
Basket

Base Year

2015-16

= 140

₹ 80 ——— ◯

◯ 110

140

₹ 72 ——— ◯