

Difference Between Fixed and Flexible Exchange Rate



Exchange rate means a rate which is used for converting the currency from one country from another country. There are two types of exchange rate a fixed exchange rate and flexible exchange rate.

Fixed Exchange Rate

- The fixed exchange rate is officially fixed by the government or a competent authority, not by the market forces.
- In fixed exchange rate wherein the government and central bank attempts to keep the value of the currency is fixed against the value of other currencies.
- The value of each currency was set in terms of gold and exchange rate was fixed according to the gold value of currencies that have to be exchanged.
- For example in India, a currency price is fixed an official price of its currency in reserve is issued by the central bank.
- Once the rate determined, the central bank undertakes to buy and sell foreign exchange and the private purchase and sales are postponed.
- An apex bank changes the exchange rate if needed.

Flexible Exchange Rate

- A flexible exchange rate is also known as a floating exchange rate.
- In a flexible exchange rate, a rate is set according to the demand and supply of market forces.
- A country's economic situation will determine the market demand and supply of its currency.
- It is particularly determined concerning other currency it means higher the demand of particular currency, the higher it's exchange rate.
- If an economy is strong the flexible exchange rate is higher and vice versa. So the government has no control over the flexible exchange rate.
- A value of the currency is fluctuated or shift freely according to the demand and supply of international exchange.

Difference Between Flexible Exchange Rate and Fixed Exchange Rate

Basis	Fixed exchange rate	Flexible exchange rate
meaning	A fixed exchange rate is a rate which is maintained and controlled by the central government.	A Flexible exchange rate is a rate which is determined by the market force.
Controlled by	A fixed exchange rate is controlled by an apex bank or a monetary authority.	A flexible exchange rate is controlled by the demand and supply forces.
How it affects currency	A fixed exchange rate has a devaluation and evaluation in a currency.	A flexible exchange rate can depreciate and appreciate the value of a currency.
Hedging	There is no hedging risk if the country is using fixed exchange rate.	Hedging is used to reduce the currency risks in the flexible exchange rate.