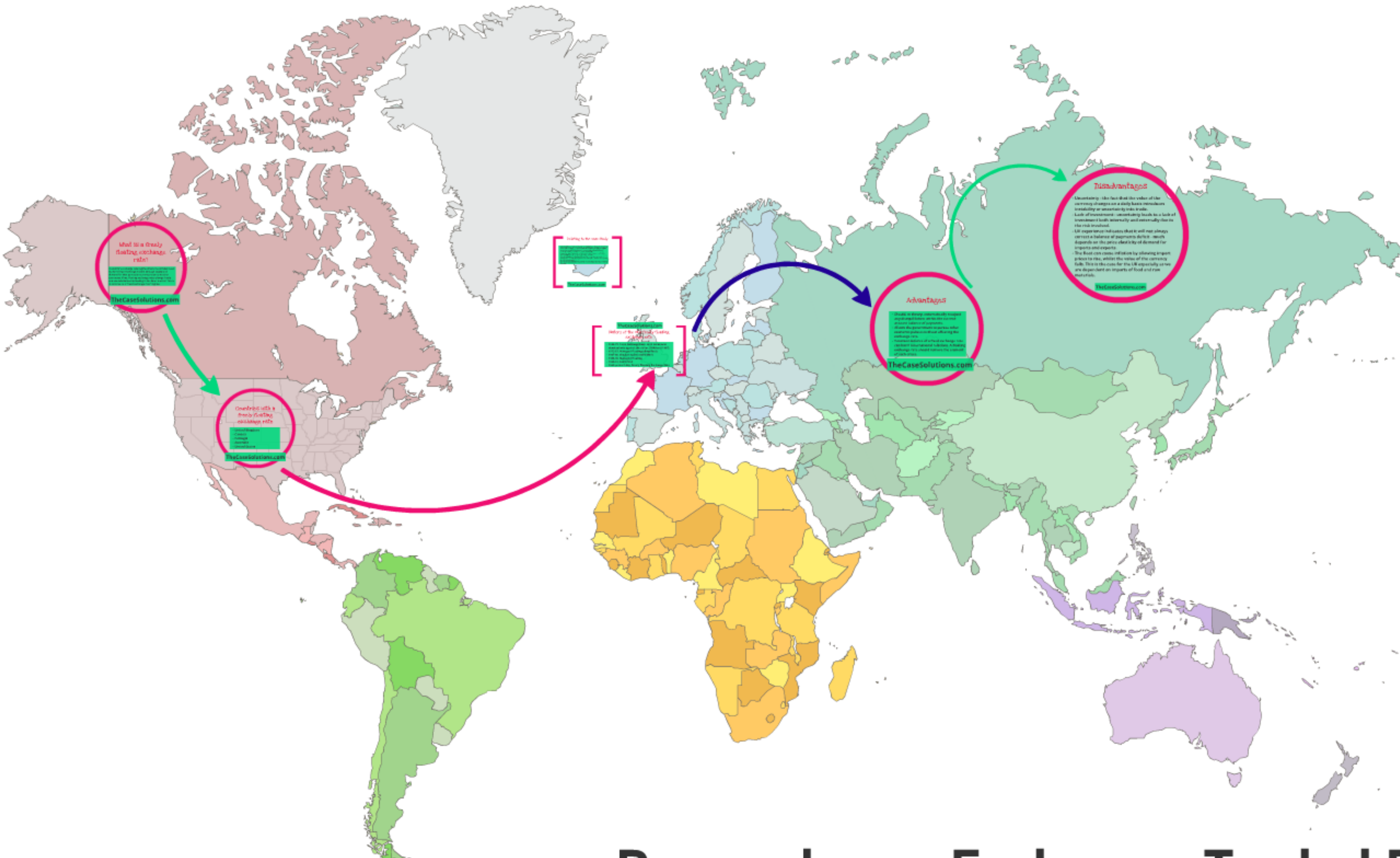


# Powershares Exchange-Traded Funds

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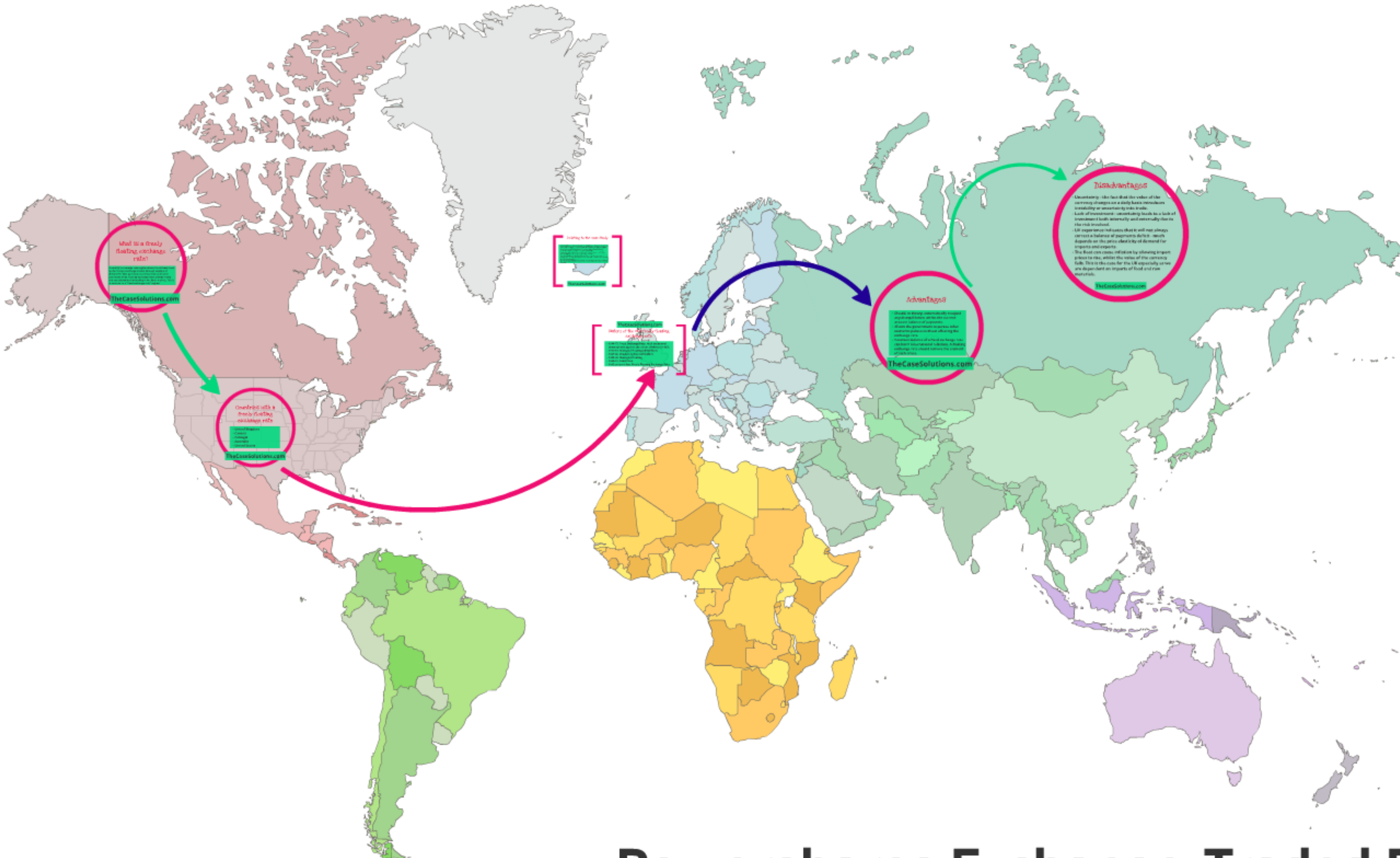


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# What is a freely floating exchange rate?

**A country's exchange rate regime where its currency is set by the foreign-exchange market through supply and demand for that particular currency relative to other currencies. Thus, floating exchange rates change freely and are determined by trading in the forex market. This is in contrast to a "fixed exchange rate" regime.**

# Countries with a freely floating exchange rate

- United Kingdom
- Canada
- Portugal
- Australia
- United States

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## History of the UK's freely floating exchange rate

- 1944-72, Fixed Exchange Rate, with occasional devaluations against the dollar. (1949 and 1967).
- 1972-87, Managed Floating (dirty float)
- 1987-88, shadowing Deutsche Mark
- 1988-90, Managed Floating
- 1990-92, Semi-fixed
- 1992-present day, Freely Floating Exchange Rate

## Advantages

- **Should, in theory, automatically readjust any disequilibrium within the current account balance of payments.**
- **Allows the government to pursue other economic policies without affecting the exchange rate.**
- **Constant defence of a fixed exchange rate can harm international relations. A floating exchange rate should remove the element of such crises.**

# Disadvantages

- **Uncertainty - the fact that the value of the currency changes on a daily basis introduces instability or uncertainty into trade.**
- **Lack of investment - uncertainty leads to a lack of investment both internally and externally due to the risk involved.**
- **UK experience indicates that it will not always correct a balance of payments deficit - much depends on the price elasticity of demand for imports and exports.**
- **The float can cause inflation by allowing import prices to rise, whilst the value of the currency falls. This is the case for the UK especially as we are dependent on imports of food and raw materials.**

# Relating to the Case Study

- Iceland pursued a floating exchange rate making Icelandic goods and services appear much cheaper. This was effective in stimulating exports without the politically unpopular and potentially economically damaging effects of austerity measures as adopted by Latvia and the UK.
- Floating Exchange Rate in Iceland caused inflation to increase to 25.2% in January 2009, however this has fallen to just over 3%.
- Iceland's adoption of a Floating Exchange Rate seems to have been less damaging in the short run and has aided recovery better than Latvia's pursuit of internal devaluation.
- GDP fell by less in Iceland and export volumes are higher and import volumes are lower.