Given the changes in the international economy, the emergence of several new, influential institutions and the relative decline of others (at least in terms of exchange rate management), the perceived strengths of the present system of floating exchange rates include:[10]

- the promotion of external payments balances;
- insulation from inflation abroad;
- the independence and effectiveness of domestic monetary policy; and
- the resilience of the floating rate system in terms of its ability to deal with major international financial strains.

The perceived weaknesses of the floating exchange rate regime are identified as:

- the short-term volatility of exchange rates;
- the existence of large and persistent misalignments of real exchange rates; and
- the system's lack of ability to promote the international coordination of macroeconomic policy.

In line with public attention, this Commentary will focus exclusively on the problems of exchange rate volatility and misalignments.

The Macroeconomic Role of Floating Exchange Rates

The precise impact of exchange rate movements on domestic prices, production and employment depends largely upon economic circumstances and government policies at the time. While there are generally accepted principles concerning the trade effects of exchange rate movements (a depreciation increases exports and reduces imports while an appreciation reduces exports and increases imports), it is easy to envision circumstances in which exchange rate changes are followed by seemingly

[10] See A. Crockett and M. Goldstein, *Strengthening the International Monetary System: Exchange Rates, Surveillance, and Objective Indicators*, IMF Occasional Paper No. 50, IMF, Washington DC, February 1987, pp. 2-10.