

EXCHANGE RATE VOLATILITY AND PRICE MECHANISM

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Abstract

Exchange rate volatility causes an uncertainty about what relative prices will be in the future. This uncertainty prevents price mechanism's knowledge function. A common exchange rate system, with European Union, leaves a stable exchange rates and less systemic risk, but it does not guarantee a World in which there is no government intervention. European Central Bank determines which policy is suitable and the best for those who are living in Europe. Additionally, implementing traditional restrictive policies, such as tariffs and quotas, to protect domestic producers against countries those are outside the Europe may create some new risks which may outweigh the risk caused by exchange rate volatility. Hence, any policies which involve government intervention can reduce individuals' welfare.