

EXCHANGE RATE REGIME IMPACT ON MACRO ECONOMY

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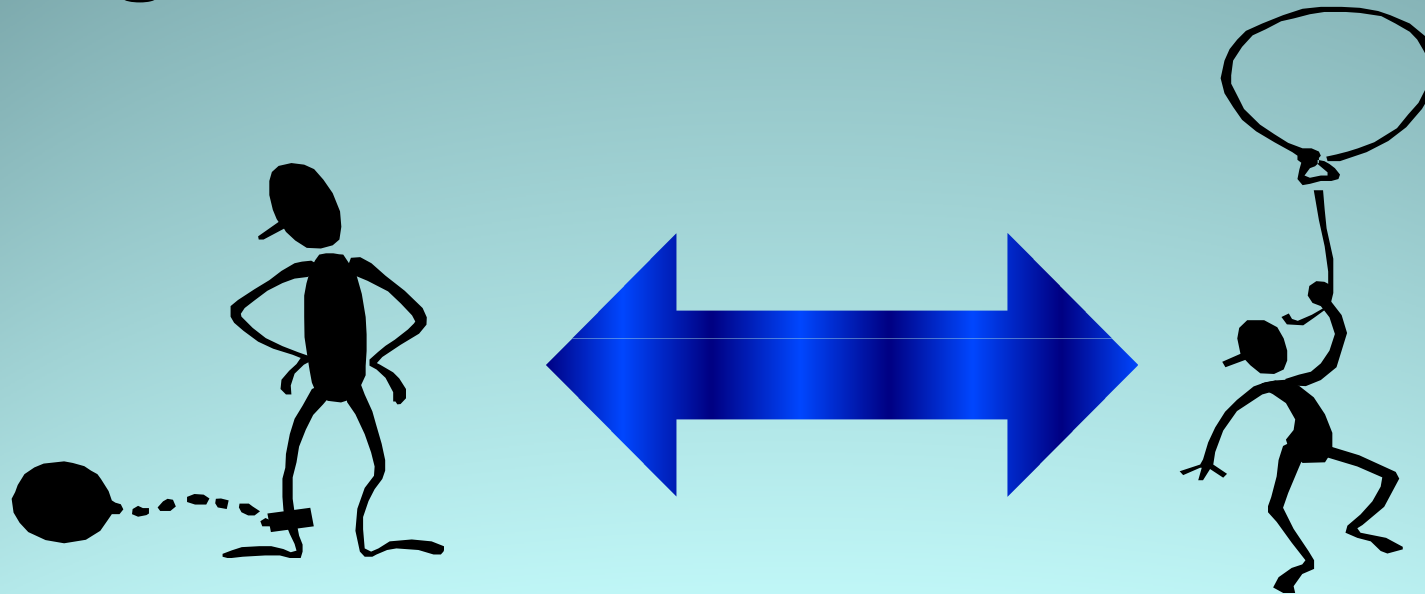
Outline

- Objectives of the Study
- Exchange Rate Regimes in Bangladesh : An Overview
- Impact on Macro Economic Fundamentals
- Summery of Empirical Evidence
- Present Currency Situation
- Recommendations
- Conclusion

Objectives

- Evaluation of Exchange Rate Regimes in Bangladesh: Fixed to Float
- Analyze It's Impact on Macro Economy: Export, Workers Remittance and Foreign Reserve.
- Exploring the Reasons of Present Currency Situation

Exchange Rate Regimes In Bangladesh :An Overview



Fixed (1972) to Float (2003)

Exchange Rate Regimes In Bangladesh : An Overview cont.

- Bangladesh had a fixed exchange rate system from January, 1972 to May 2003.
- After more than 31 years, Bangladesh Bank changed it into a floating exchange rate system in June 2003.
- The reasons behind adopting new system was:
 - Government's commitment to the liberalization of the country's economy
 - IMF's 'Conditional^{ity}'

Source: BB Financial Sector Review (2006)'

Exchange Rate Regimes In Bangladesh : An Overview cont.

1972: Taka used to float with US\$ via British Pound Sterling/GBP.

1975: Government adopted an expansionary monetary policy resulted high inflation and trade deficit.

1983: Facing serious macroeconomic problems, the government, for the first time accepted "do gooder's" i.e. World Bank-IMF's structural adjustment credit under 'conditionality' that involves deflationary macroeconomic policies and elimination of various subsidy programs.

1991: During this period, Government took some major reform in the exchange rate arrangements like :

I. Unified the exchange rate regime in January 1992 by abolishing the secondary exchange market.

II. Removed some exchange controls in current account transactions.

III. In April 1994 government accepted the Article VIII obligation of the IMF.

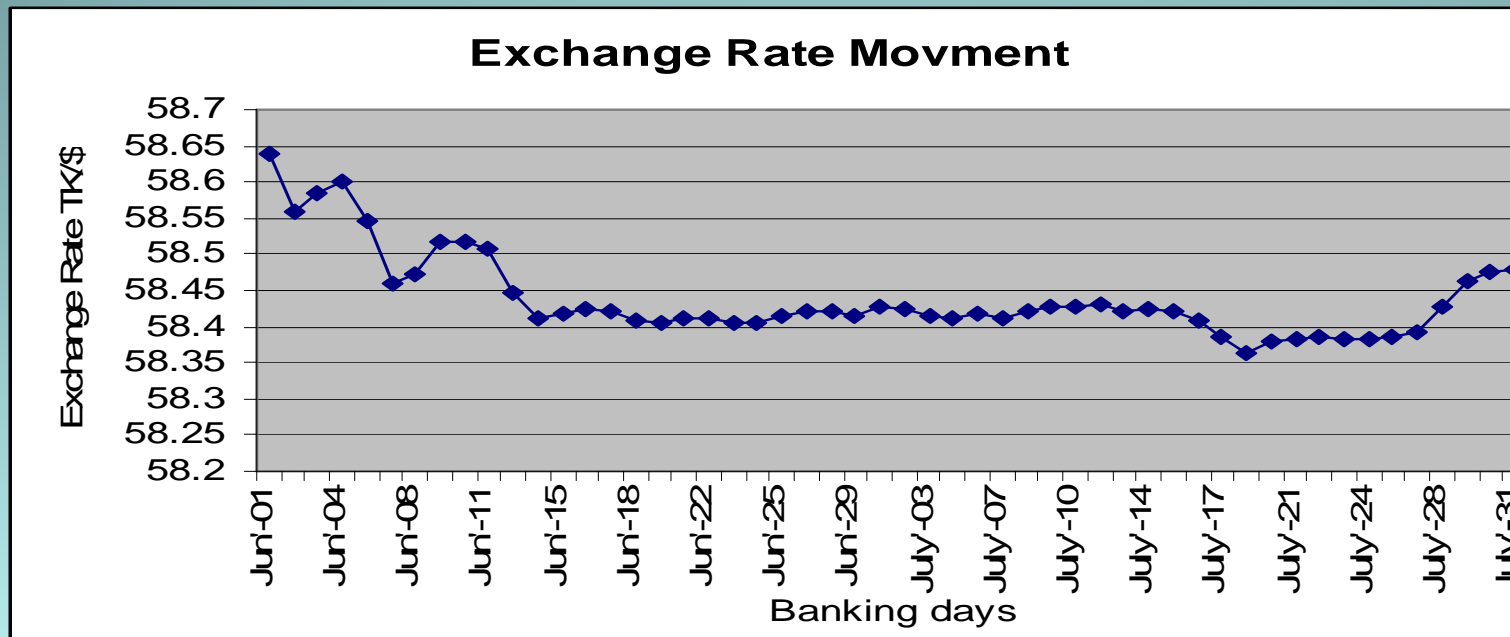
IV. The removal of exchange controls induced inflows of WR through the official channels.

2003 : To meet up the economic demand and to fulfill the aid conditionality, on 29 May Bangladesh Bank issued a circular stating- effective from 31st May, 2003, Bangladesh Bank floated its exchange rate and followed a fully market based exchange rate for Taka. Under this arrangement, exchange rate is determined on the basis of demand and supply of the respective currencies.

Source: *Hossain, Aktar.2002.Exchange Rate, Capital Flows and International Trade*

Exchange Rate Regimes In Bangladesh : An Overview cont.

Figure: Exchange Rate Movement immediately after inception of Floating



After the introduction of free floating exchange rate system, there was no unusual raise of exchange rate till mid 2004.

Growth rate of GDP (% per year), Current Account Balance as Percentages of GDP, Inflation : Comparison with some neighboring countries

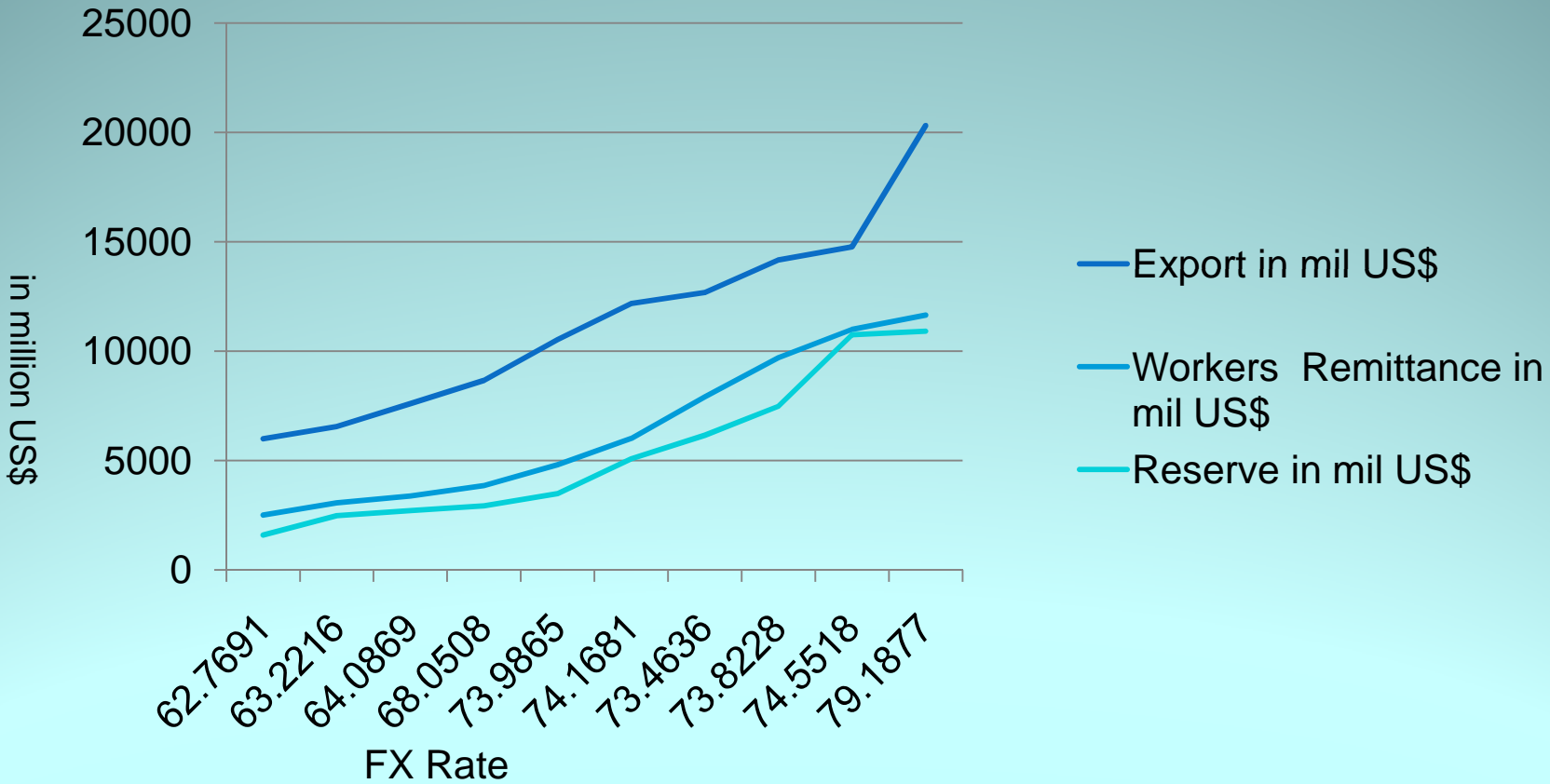
Source: ADB Outlook'2011

GDP	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Bangladesh	5.3	4.4	5.3	5.7	6.0	6.6	6.4	6.2	5.7	5.8	6.3
India	5.8	4.0	8.2	7.4	7.6	9.7	9.2	6.7	8.0	8.6	8.2
Sri Lanka	-1.5	4.0	5.9	5.0	5.5	7.7	6.8	6.0	3.5	7.6	8.0

C/A	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Bangladesh	-2.3	0.4	0.5	0.0	-1.5	1.3	1.4	0.9	2.7	3.7	0.2
India	0.2	0.8	0.7	0.3	0.3	-1.2	-1.4	-2.4	-2.8	-3.0	-3.5
Sri Lanka	-1.5	-1.8	-2.2	-3.0	-3.5	-5.3	-4.3	-9.5	-0.5	-3.8	-4.0

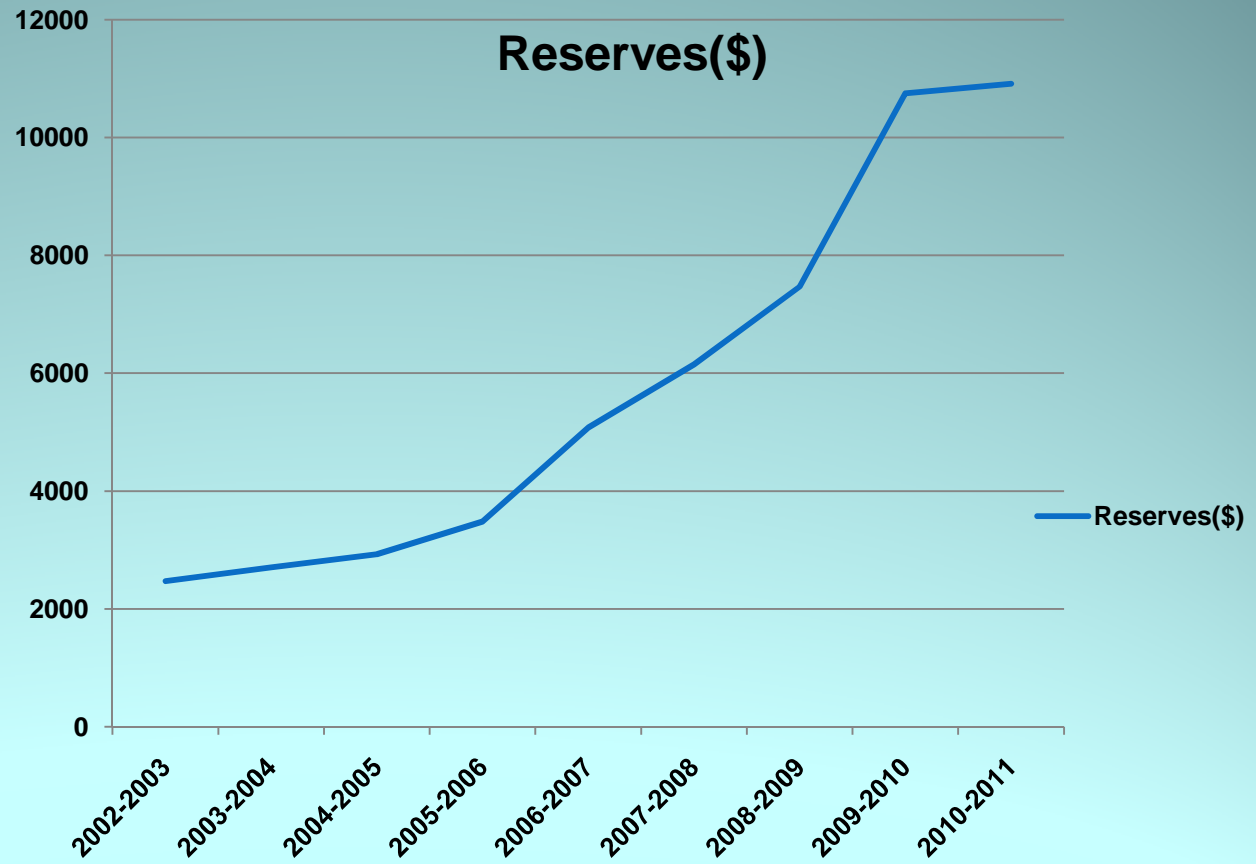
Inflation	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Bangladesh	1.6	2.8	4.4	4.7	5.2	7.2	7.2	9.9	6.7	7.3	8.0
India	4.7	3.4	5.3	5.0	5.0	5.2	5.0	8.7	2.1	9.2	7.8
Sri Lanka	11.0	10.2	2.6	-	-	10.0	15.8	22.6	3.4	5.9	8.0

Impact on Macro Economic Fundamentals Export, Remittance, Reserve (FY 02-FY11)



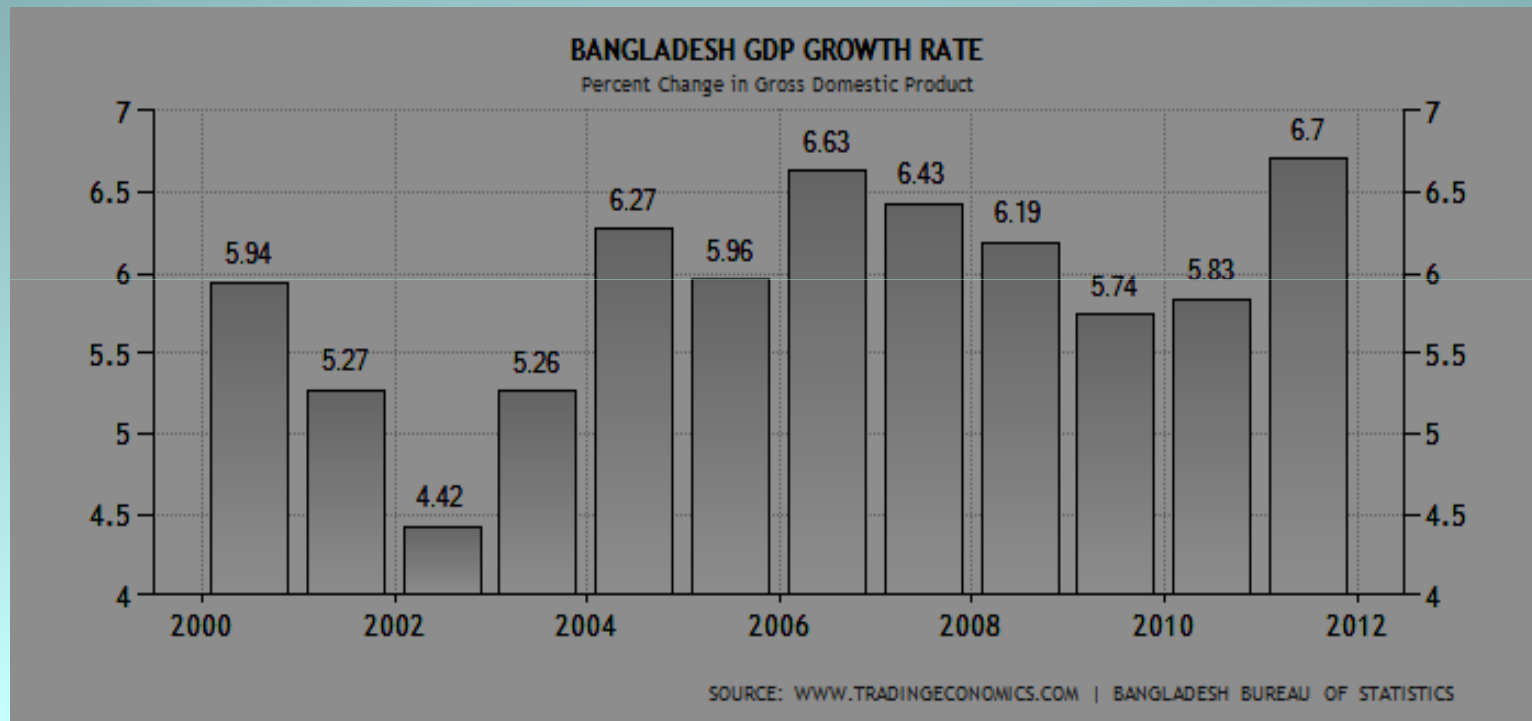
FOREIGN RESERVE

Period	Reserves (\$)
2002-2003	2469.6
2003-2004	2705
2004-2005	2930
2005-2006	3483.8
2006-2007	5077.2
2007-2008	6148.8
2008-2009	7470.9
2009-2010	10749.7
2010-2011	10911.6



-reserve position increased over the years from 2003-2011

Impact on Macro Economic Fundamentals : The Growth Rate of GDP



Impact on Macro Economic Fundamentals: Relationship FX rate and Remittance

Correlation Matrix:

Correlation	Export	Remittance	Reserve
Exchange Rate	0.928315219	0.859373146	0.825444493

Regression Analysis: Regression Model

$$Y=66.15+.010385 \text{ remittance}$$

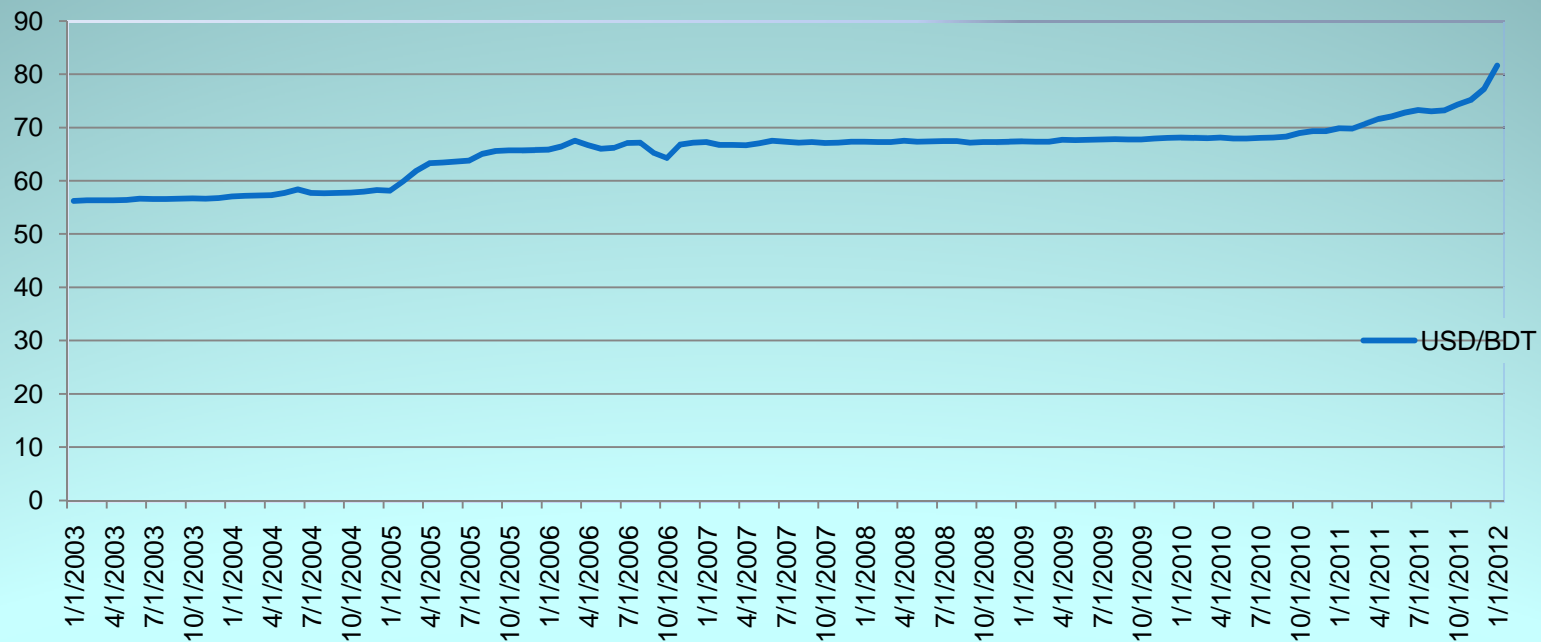
The value of R square is .37 which means that the regression model explains 37% variation in exchange rate. The coefficient is very low which is and P value is quite high that is 3.74. So, the remittance does not show any significant impact on foreign exchange rate.

Summery of Empirical Evidence

1. There is strong evidence that exchange rate regimes have a clear, significantly negative impact on growth. *William Miles, 2006*
2. Regime change has no statistically significant impact on the value of Bangladesh currency once foreign exchange reserve is incorporated in the regression model. *Asad Karim Khan, June 2009*
3. High seasonal demand for foreign currency because of increased import bills, systematic withdrawal of excess liquidity by Bangladesh Bank, relatively faster expansion of credit and higher interest rates on various national savings instruments are the reasons behind the interest rate hike in the money market and depreciation of the nominal exchange rate. *Rahman and Barua (2006)*

Present Currency Situation

In the recent Taka depreciates against US\$ drastically: Over the period, July 2010-January 2012, from Tk 70 to Tk 86 -- a depressing 23% fall down.

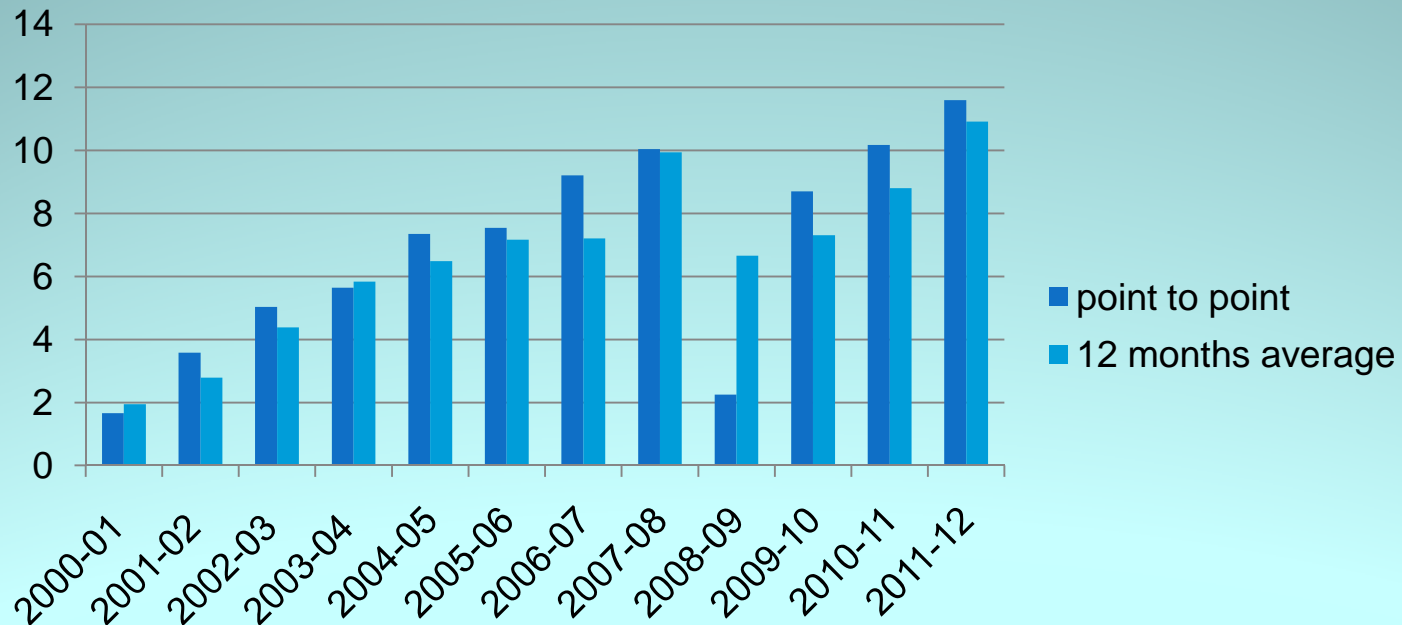


Present Currency Situation *cont*

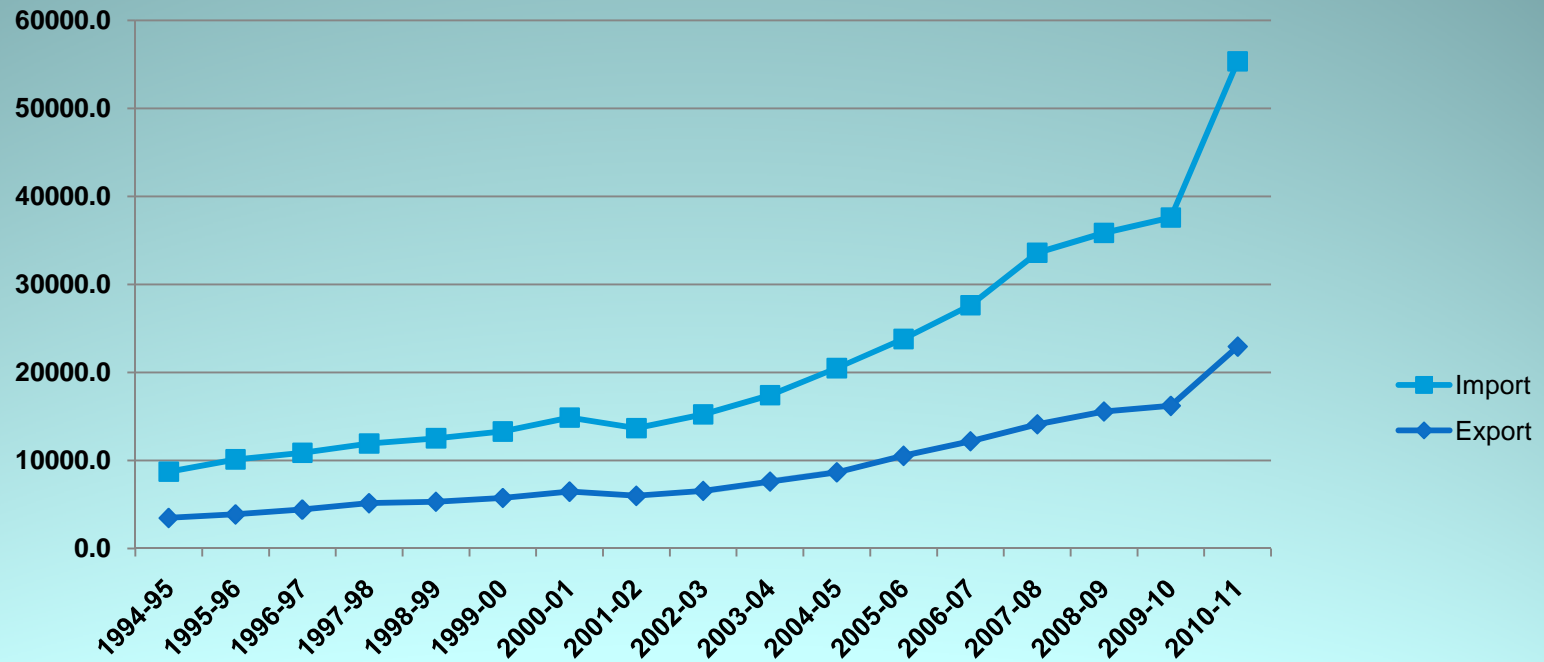
- ❑ The current account balance recorded a deficit of 372 million U. S. dollars in the July-October period in the current financial year 2011-2012.
- ❑ Taka depreciates against US\$ drastically: Over the period, July 2010-January 2012, from Tk 70 to Tk 86 -- a depressing 23% fall down.

Reasons for Currency Depreciation

High Inflation:



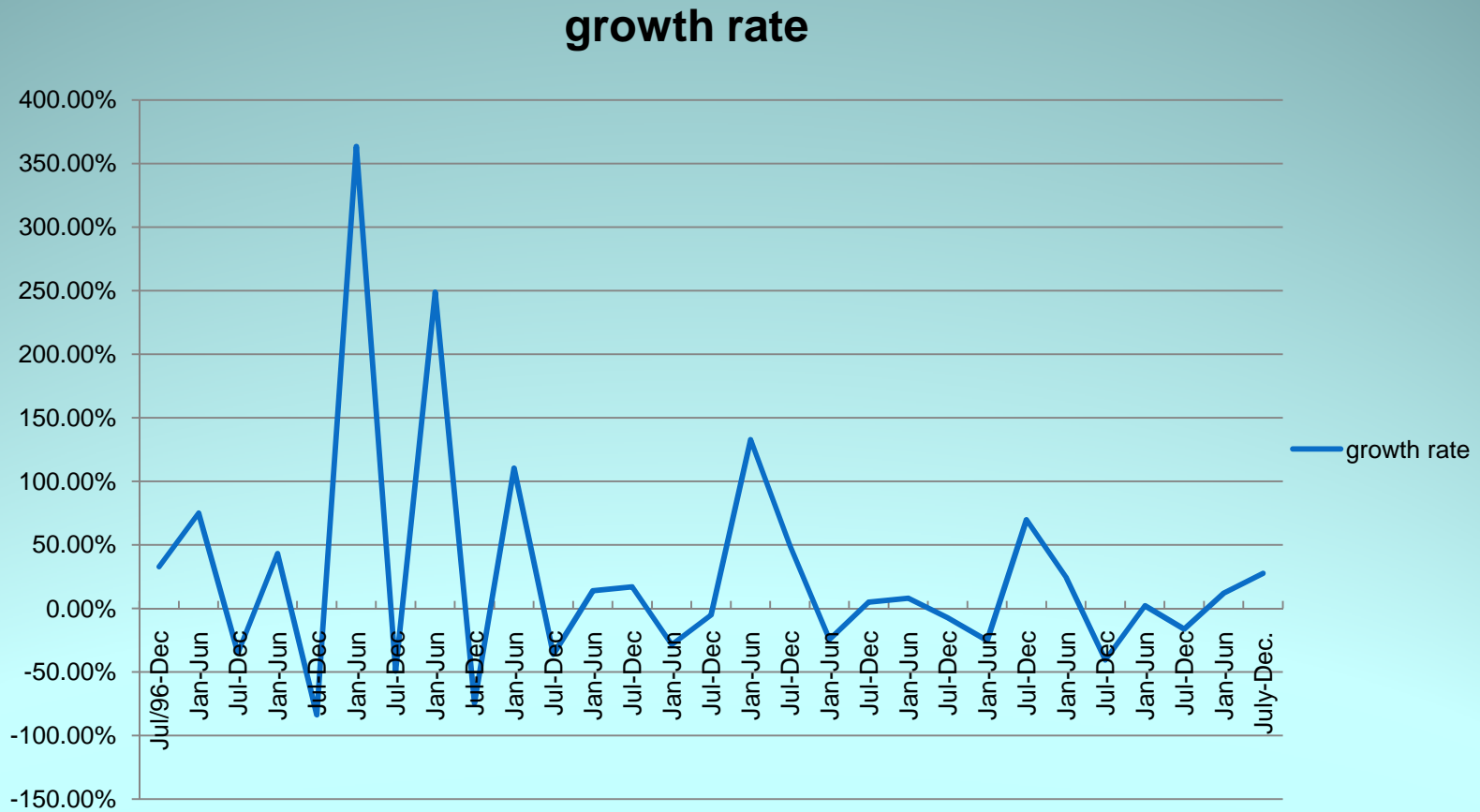
Trade Deficit



Figures: In million US\$

IMPORT > EXPORT: CREATES DEMAND FOR FOREIGN CURRENCY

Low Foreign Direct Investment:



Recommendations

1. Control Inflation
2. Reduce Trade Deficit
3. Enhancing Foreign Direct Investment
4. Short Term Foreign Borrowings
5. Effective Capital Market
6. Derivatives Market
8. Autonomy of the Central Bank

Conclusion

- ✓ Government and Regulator (BB) should formulate Macro Economic (Fiscal and Monetary) Policy Objectives with the consistency of FX regime.
- ✓ The development of macro economic fundamentals does not primarily depends on FX regime.



Thank You