

# Bangladesh exchange rate assignment assignment

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A brief history of Exchange rate of Bangladesh Since Bangladesh was the part of Pakistan called East Pakistan, shared the same currency and trade-policy history as the rest of Pakistan until the liberation of Bangladesh. Bangladesh take was created on January 1 1972. Pakistan rupees in circulation remained legal tender until replaced by the take beginning March 4 1972. The take was set at par with the Indian rupee, and fixed to sterling at TX 18. 9677, or TX 7. 2797 to the United States dollar. The path followed by the take was determined partly by the initial value chosen for the new currency in 1972.

Given the devastation experienced by the Bangladesh economy from natural disaster, civil war and war in 1969-1971, the initial value chosen for the take on par with the Indian rupee was in all likelihood unrealistic, even more so to the extent the Indian rupee was itself nominally overvalued at the time. In that time, the principal fact about official exchange-rate policy in Bangladesh has had to do with overseas workers' remittances far exceeding any single sector of merchandise exports as a support for the balance of payments.

A multiple exchange-rate system prevailed with a secondary market as an incentive for overseas workers to remit through official channels instead of at parallel or "Hindi" market-rates, the spread between the parallel and official channels being exceptionally high for Bangladesh compared to India and Pakistan. MIFF technical studies laid the groundwork for abolishment of the multiple exchange- rate practice and the unification of exchange-rates, which was accomplished on March 31 1992. The path of the official take is informative as a measure of nominal overvaluation.

Since August 1979, the official take has been pegged within margins to a currency-weighted basket. The take was adjusted as many as 20 times between October 1980 and January 1982, the official rate being reduced to TX. 38. 4 to sterling or TX. 20. 4 per United States dollar. In January 1983, the weights were changed and in March 1985 changed again. On this basis, the nominal effective exchange rate depreciated by 29 percent and the real effective exchange rate by 21 percent between August 1979 and December 1982.

From February 1985, exchange-rate policy has with MIFF support tried to keep in mind an upper limit on the real effective exchange, the nominal rate declining in one year by 20 percent and the real rate by 22 percent. From the end of 1985 through November 1988, there was further depreciation of 4 percent. In absence of further nominal depreciation, combined with further deterioration of the domestic price-level, the real exchange rate appreciated by 7 percent between November 1988 and April 1989, followed by further appreciation of over 9 percent during May-June 1989.

A revised index confirmed the loss of competitiveness, indicating at least 12 percent real appreciation by end June 1989 relative to 1988. From November 1988 to February 1990, the take remained at TX 32. 27 per United States dollar with the official secondary market 2 percent higher. In 1990 the rates were depreciated six times by a total of 11 percent, corresponding to 8 percent real depreciation. The official take was at TX. 36. 49 per United States dollar as of July 7 1991.

Recent Bangladesh exchange-rate policy has seemed to be guided by such considerations, and has not been responsive to regional developments such as changes in the Indian rupee. Exchange rate regime from Independence till June 1999: Changes to the exchange rate regime 1 January 1972 The Bangladesh Taka (TK) was created to replace the Pakistan Rupee as national currency, and was linked to the Pound Sterling at a fixed rate of Tack. 677= E, resulting in an Official Rate at Tack. 27927 per US. Dollar. (WAC 1984, p. 1) 11 February 1972 Bangladesh became a member of the Sterling Area. (WAC 1984, p. 91) 4 March 1972 All Pakistan Rupee money in circulation was considered legal tender until replaced by the new Taka currency on a one-for-one basis beginning 4 March 1972. The currency changeover represented a devaluation of 34.6% in terms of gold. (WAC 1984, p. 91) June 1972 With the collapse of the Pound and the dismantling of the Sterling Area, the Taka maintained 27 July 1972 A Taka or Secondary Exchange Market (SEEM) Rate of Tack. 0= E. 0 was created for foreign currency remittance from Bangladesh nationals abroad, under the Wage Earners' Scheme (WEST) and from freely negotiable Import Entitlement Certificates issued under the Export Performance Licensing Scheme, a partial devaluation. (WAC 1985, p. 93) 13 February 1973 Following the devaluation of U. S. Dollar devaluation, Dacha announced that the Effective Rate for the Taka would continue to float through its link to Sterling. However, based on the Taka's unchanged gold content, the Taka was realigned to Tack. 55 per US. Dollar. (WAC 1984, p. 91) 1 July 1974

A Resident Travel Rate was created via a 30% tax on foreign exchange authorized for travel abroad by residents. (WAC 1984, p. 91) 17 May 1975

The exchange rate structure was unified by the abolition of the 30% exchange tax applicable to certain purchases of travel exchange, and of the Scheme for Home Remittance. (MIFF 1976, p. 67) The Task's link to the Pound Sterling was changed from Tack. 9677 to Tack. 00 per British unit, thereby devaluation the Bangladesh currency's theoretical gold content by 36. 77% and changing the inoperative Official Rate to Tack. 36 per U. S. Dollar.

The Resident Travel Rate was abolished. (WAC 1984, p. 91) Date 1976 Exchange rates for currencies other than Sterling are based on the London market rates for the currencies concerned. (IMP 1977, p. 61) 26 April 1976 Beginning 26 April 1976, the Take Rate and the Effective Rate were periodically adjusted against the Pound Sterling. (WAC 1984, p. 91) Bangladesh established a Central/Middle Rate for the Take of Tack. 1= E and availed itself of wider margins. (MIFF 1976, p. 64) 7 June 1976 The Middle Rate of the Take was adjusted from Tack. 1= E to Tack. 7= E. (MIFF 1976, p. 65) 3 November 1976

The Middle Rate of the Take was appreciated from Tack. 7= E to Tack. 45= E. (MIFF 1976, p. 65) 31 December 1976 The Official Exchange Rate was Tack. 975= E. (MIFF 1977, p. 61) 31 December 1977 The Official Exchange Rate was Tack. 625= E. (MIFF 1978, p. 53) 29 December 1978 The Middle Rate of the Take was Tack. 525= E. (IMP 1976, p. 65) 15 January 1979 The Official Exchange Rate was changed to Tack. 125= E. (MIFF 1979, p. 56) 16 April 1979 The Official Exchange Rate was changed to Tack. 025= E. (MIFF 1980, p. 57) 28 May The Official Exchange Rate was changed to Tack. 00= E. (MIFF 1980, p. 7) 13 August 1979 The intervention currency remained the <https://assignbuster.com/bangladesh-exchange-rateassignment-assignment/>

Pound Sterling. The value of Take was determined on the basis of a weighted basket of currencies, with fluctuation margins of 2.5% on either side. The Middle Rate of the Take was changed to Tack. 7118= E. (MIFF 1980, p. 54) 29 July 1980 The exchange rate of the Take against the Pound Sterling was changed to Tack. 275= E. (MIFF 1981, p. 65) 13 October 1980 The exchange rate of the Take was subsequently changed to Tack. 45= E. (MIFF 1981, p. 65) 27 October 1980 The exchange rate of the Take was subsequently changed to Tack. 92= E.

In the injection with the exchange rate change, the margins were narrowed to 1% on either side. (MIFF 1981, p. 65) 31 December 1981 The Middle Rate of the Take was changed to Tack. 0068= E. (MIFF 1982, p. 72) 11 January 1982 The Bangladesh Bank changed the rate of Take against the Pound Sterling from Tack. 0068= E to Tack. 4220= E, representing a devaluation of 1.08%. (MIFF 1983, p. 91) August 1982 The Bangladesh Bank changed the middle rate of Take against the Pound Sterling from Tack. 4220= E to Tack. 00= E, representing a devaluation of 1.48%. (MIFF 1983, p. 91) 11 January 1983 The intervention currency was changed to the U.

S. Dollar. (WAC 1984, p. 91) Exchange rate for currencies other than the U. S. Dollar are based on the U. S. Dollar closing rates in New York for the currencies concerned. (MIFF 1984, p. 82) 7 July 1984 The exchange rate under the Wage Earners' Scheme (WEST) previously negotiated freely, was now to be established by a committee of authorized dealers set up by the Central Bank. (WAC 1986/87, p. 404) 1 July 1985 The Export Performance Licensing Scheme was replaced with an Export Performance Benefit Scheme

(XP) and Import Entitlement Certificates became available only under the Wage Earners' Scheme.

For most nontraditional exports, a rate based on 100% of the Secondary/ Take Rate was to be used, while other export receipts were governed by a mix of either 1) 40% at the Secondary and 60% at the Effective Rate or 2) 70% at the Secondary and 30% at the Effective Rate. Earnings from raw jute, loose tea and wet blue leather were exchangeable at the Effective Rate. (WAC 1986/87, p. 404) The Secondary Exchange Market, comprised of the Wage Earners' Scheme and the Export Performance Benefit Scheme, became a free interbrain market and was made applicable also to tourist receipts and most other services receipts.

WAC 1988/89, p. 409) 31 December 1985 The Official Exchange Rate for the Take was adjusted on 14 different occasions during the year, from Tack. 00= US\$1 at the end of 1984 to Tack. 00= US\$1 at the end of 1985, involving a depreciation of 16. 13%. (MIFP 1986, p. 114) 31 December 1986 The Middle Rate for the Take in terms of U. S. Dollar was adjusted on 4 occasions during the year, from Tack. 0= Los\$1 at the end of 1985 to Tack. 80= Los\$1 at the end of 1986. (MIFP 1987, p. 100) 31 December 1987 The Middle Rate for the Take in terms of U. S.

Dollar was adjusted on 3 occasions during the year, from Tack. 0= US\$1 at the end of 1986 to Tack. 20= US\$1 at the end of 1987. (MIFP 1988, p. 94) 17 March 1988 The SEEM Rate, instead of the Official Rate, was applied to all encashment of export receipts of the industrial unit in the Export Processing Zone (Peps). The SEEM Rate was also applied to encashment of funds

brought in from abroad by the units in Peps for meeting their local expenses. (MIFP 1989, p. 38) 12 November 1988 The Secondary Market Rate did not change during the year and remained at Tack. 925= US\$1.

The spread between the official Middle Rate and Secondary Exchange Market (SEEM) Rate was reduced below 2%. MIFP 1989, p. 38) 31 December 1988 The Middle Rate for the Take in terms of U. S. Dollar was adjusted on 5 occasions during the year, from Tack. 20= US\$1 at the end of 1987 to Tack. 27= US\$1 at the end of 1988. (MIFP 1989, p. 38) The Middle Exchange Rate in the secondary market was Tack. 925 per US\$. (MIFP 1989, p. 33) 1 July 1989 A cash subsidy of 10% to 20% was granted exports of jute in lieu of the XP. (WAC 1990/93, p. 401) 31 December 1989 The Middle Exchange Rate in the secondary market was Tack. 25 per US\$. (MIFP 1989, p. 33) 1990 During 1990, the Effective Rate was depreciated six times totaling 9.3%. (WAC 1990/93, p. 40) 31 December 1990 The Middle Exchange Rate in the secondary market was Tack. 505 per US\$. (MIFP 1991, p. 34) 27 February 1991 The Middle Rate of the Take in terms of U. S. Dollar has been adjusted on several occasions, changed from Tack. 79 per US\$ to Tack. 58 per US\$. The SEEM Rate changed from Tack. 505 Per US\$ to Tack. 725 per US\$. As a result, The official Middle Rate and SEEM Rate were cut 7.2% and 5.7%, reducing the spread between the two from 2% to 0.8%. 31 December 1991 1992, p. 38) 1 January 1992 The Secondary Exchange Market System (i. E. The Wage Earners' Scheme and the Export Performance Benefit Scheme) was abolished, and the exchange rate system was unified. (MIFP 1993, p. 48) July 1993 The dealings of Bangladesh Bank with domestic authorized banks were restricted to U. S. Dollar and the currencies of member countries of the Asian



Clearing Union (ACE). Authorized banks are free to set their own buying and selling rates for the U. S. Dollar and the rates for other currencies based on cross rates in international markets. MIFF 1994, p. 45) Remark: Members of the Asian Clearing Union are Bangladesh, India, the Islamic Republic of Iran, Manner, Nepal, Pakistan, and Sri Lanka. August 1993 The spread between the Task's buying and selling rates of the Central Bank was widened from 20 to 30 per U. S. Dollar. (WAC 1990/93, p. 401) 1 January 1996 Bangladesh Bank ceased to deal in the currencies of the other ACE member countries and deals with authorized domestic banks only in U. S. Dollar and the rates for other currencies, based on cross rates in international markets. MIFF 1997, p. 65) 5 July 1998 The authorities widen the buy/sell margin from 20 to 30 points (to approximately from 0.4% to 0.7%). (MIFF 1999, p. 69) 1999 At the end of 1999, the buy/sell margin was approximately 0.6%. MIFF 2000, p. 72) Exchange Rate Systems-Followed by Bangladesh since independence (types) Exchange rate systems can be classified according to the degree by which exchange rates are controlled by the government. Exchange rate systems normally fall into one of the following categories: 1. Fixed Exchange Rate 2. Floating Exchange Rate 3.

Pegged Exchange Rate Fixed Exchange Rate: In a fixed exchange rate system, exchange rates are either held constant or allowed to fluctuate only within very narrow boundaries. If an exchange rate begins to move too much, governments intervene to maintain it within the boundaries. In some situations, a government will devalue its currency while in other situations it will revalue its currency against other currencies. Advantages: Countries are able

to engage in international trade without worrying about the future exchange rates. It reduces the risk of doing business in that country too.

Disadvantages: The government may manipulate the value of the currency. Also, a fixed exchange rate system may make each country more vulnerable to economic conditions in other countries. Floating Exchange Rate: Floating rate systems can be further classified into 2 subcategories: a. Freely floating exchange rate system: Also known as a clean float. In a freely floating exchange rate system, exchange rate values are determined by market forces without intervention by the governments. Advantages: A major advantage of this system is the insulation of a country from the inflation or unemployment problems in other countries.

An additional advantage of this system is that a central bank is not required to constantly maintain ERE within specified boundaries. Disadvantages: A country's economic problems can sometimes be compounded by freely floating ERE. Under such a system, Macs would need to devote abstaining resources to measuring and managing exposure to ERE fluctuations. B.

Managed float exchange rate system: Also known as a dirty float. It is similar to a freely floating system in that exchange rates are allowed to fluctuate on a daily basis and there are no, official boundaries.

It is similar to a fixed rate system in that governments can and sometimes do intervene to prevent their currencies from a sharp fall. Advantage: It prevents a crash in the value of the currency, should it happen.

Disadvantage: Some criticize such a policy as it seeks to protect the home currency at the expense of others. Pegged Exchange Rate: Under such a

system, the value of the home currency is pegged to a foreign currency. The pegged currency moves in line with that currency to which it is fixed against other currencies.

Some currencies such as the Argentine peso or the Chinese Yuan are pegged against a single currency (US dollar) while some others are pegged against a composite of currencies such as the composite of European currencies.

Advantage: If a country conducts most of its trade with another country then pegged system yields benefit to both these countries as it virtually eliminated the exchange rate risk. Current Exchange Rate System of Bangladesh The Bangladesh Bank (B) set foreign currency exchange rate band free from any regulation on May 29, 2003.

It came into effect, officially from June 1, Saturday, when banks started to fix buying and selling rates of dollar and other currencies according to supply and demand situation under the free-float system. The B however said that it would keep an eye on the market and intervene in money market and US dollar selling and purchase transactions whenever needed. The B also said that it would deal with banks on dollar on a case-to-case basis. Though the official change came on May 29, B was effectively pursuing the freely floating rates and did allow the banks to determine the rates for the past one year.

The observed volatility was not significant during this period, which encouraged the B to take this long awaited step. The attraction of a floating exchange rate system is, that at least in theory it provides a kind of automatic mechanism for keeping the balance of payments in equilibrium.

Besides, progressive devaluation of the Bangladesh currency, arising out of the fixed exchange rate, has been a regular feature during the last three decades. The devaluations and their effects on the economy subjected the governments to regular criticism by those affected by the same.

Under the floating rate system, the need for such official devaluation of the currency will cease. However, the finance minister indicated that the new exchange rate system will not be totally devoid of official influence. The Bangladesh Bank is likely to resort to buying and selling of foreign currency from time to time to indirectly play a stabilizing role in exchange rate operations. For example, when the floating exchange rate system was made operational in Pakistan, the same led to a jump in the exchange rate of the Rupee by ten or fifteen per cent on the first day.

Thus, Bangladesh had provision for similar safeguards. Reasons for Changing the Fixed Rate System to Floating Some of the reasons the ERE system was changed are discussed below: 1 . Balance of Payments disequilibrium can automatically be restored to equilibrium. When the economy experiences a balance of payments deficit, there is excess demand for the foreign currency and the exchange rate of the local currency depreciates. This may have the effect of automatically restoring equilibrium.

In such case, the value of local commodities falls from foreigners' perspective making them more attractive abroad hence increasing export and value of foreign goods increases from domestic perspective making them less attractive locally. Both could lead to an improvement in the balance of payments situation. 2. May decrease inflationary pressures and

improve international competitiveness. A floating exchange rate can reduce the level of inflation in Olds like Bangladesh. Allowing the exchange rate to float freely should ensure that exports do not become uncompetitive. The basic idea comes from the Purchasing Power Parity theory.

A high rate of inflation tends to make the exports uncompetitive. 3. To keep pace with the other markets in South Asia where India (in 1998), Pakistan (in 2000) and Sri Lanka (in 2001) have already introduced the floating rate system. (Islam, 2003) 4. Donors had also been putting pressure on Bangladesh to go for the floating exchange rate system and reportedly, obtaining foreign assistance from them also depended somewhat on introducing the new floating exchange rate system. Hence, it can be argued that pressure from the MIFP and the World Bank was an important factor behind the regime change.