“INTERNATIONAL FINANCE (AFU 08504)”

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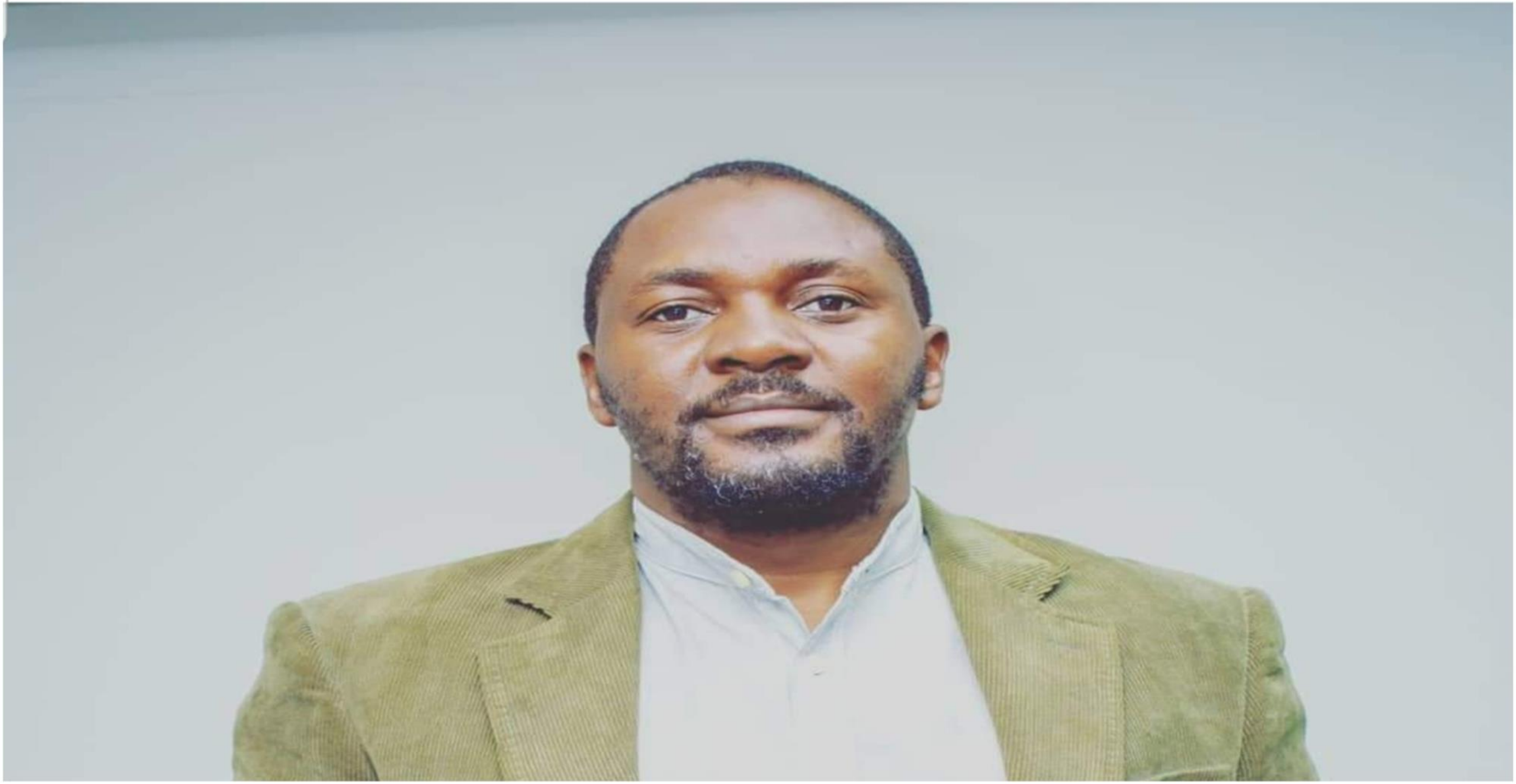
EXCHANGE RATE SYSTEM !

...LifeIsOn. Conquering tommorow is an art of mindest. Get it right. Be positive.

#IndiaelsInnerWisdom
#HekimaYaNdaniYaIndiael
#InspirationalQuotes



Exchange Rate Systems

The International Monetary System!

- IMS is the institutional framework within which *international payments are made*, the *movements of capital* accommodated and exchange rate determined.

  - The Represents **system** of international arrangements, rules , policies, institutions in regard to exchange rates, international payments and capital flows.

  - It facilitates international payments , movement of capital globally and determination of exchange rate.

The International Monetary System!

Evolution of International Monetary System

- The IMS can be traced through; Bimetallism: pre – 1875; Classical Gold Standard: 1875 – 1914; Interwar Period: 1915 – 1944; Breton Woods System: 1945 – 1972 and Current Exchange Rate Regimes: 1973 – present day.

Bimetallism: pre – 1875

- Double standard commodity monetary system - where silver and gold were both used for international payment and local transactions.
- Gold and silver were used as money (coinage) and for international debt settlement.
- Under a bimetallic standard the silver/gold ratio was fixed at a legal rate.

Under a bimetallic standard countries would experience "**Gresham's Law"** which is when "bad" money drives out "good" money.

- The **more desirable, superior form of money is hoarded** and withdrawn from circulation, and people use the inferior or bad money to make payments.

The International Monetary System!

- **Evolution of International Monetary System**
- **Classical Gold Standard: 1875 – 1914**
  - The underlying idea behind the gold standard was that governments guaranteed the conversion of currency into a specific amount of gold.
  - The currencies of countries were freely convertible into gold and this enabled all international financial settlements to be made in gold.
  - The money supply of a country was constrained by its available supply of gold reserves – such that an expansion of money supply would require an expansion of the country's gold reserves.

The International Monetary System!

- **Classical Gold Standard: 1875 – 1914**
  - Misalignment of exchange rates and international imbalances of payment were automatically corrected by Hume's 'price-specie-flow' mechanism (cross-border flows of gold) – an automatic balance of payments mechanism which would balance international payments.
  - Whereby any BoP surplus *caused an inflow of gold* into the central bank which enabled it to expand its domestic money supply (MS) without fear of having insufficient gold to meet its liabilities. The increase in the MS would increase prices resulting in reduced demand for the country's exports and, therefore, a fall in the balance of payments surplus.
  - **With a balance of payments deficit the opposite could be expected Supply and demand are automatically corrected**.

The International Monetary System!

Interwar Period: 1915 – 1944

- Redemption of banknotes in gold was suspended by major countries, which also placed embargoes on gold exports.
- There was a rise in economic nationalism, instability, bank failures and panicky flights of capital across borders, exacerbated by the ***Great Depression*** and the international financial crisis (late 1920s/early 1930s).
- Attempts were made to restore the gold standard but participants lacked the political will to 'follow the rules of the game'.

- The 'gold bullion standard', adopted by the UK in 1945 - where gold bars were bought and sold by the Bank of England.

- The **'gold exchange standard**' - under which home currency would be exchanged for certain other currencies rather than for gold itself.

The International Monetary System!

Breton Woods System: 1945 – 1972

- After World War II, a modified version of the gold standard monetary system, the Breton Woods monetary system, was created .
- This system was initially successful, but depended heavily on gold reserves, it was abandoned in 1971 when U.S president Nixon "closed the gold window.
- Named after a 1944 meeting of 44 nations at Bretton Woods the purpose was to design a post-war framework for a new international monetary system with ultimate goal of ensuring exchange rate stability without the gold standard through Fixed Exchange rate system.
- The result was also the creation of the **IMF and World Bank (BRETTON WOOD INSTITUTIONS)**.
- **The Bretton Woods system** was a dollar-based gold exchange standard designed to create stability, prevent a recurrence of economic nationalism and plays a positive role in the rapid expansion of world trade.

The International Monetary System!

Breton Woods System: 1945 – 1972

- The U.S. dollar replaced gold as the main standard of convertibility for the world's currencies
- The U.S. dollar became the only currency that would be backed by gold - this turned out to be the primary reason that Bretton Woods eventually failed.
- A system of fixed exchange rates on the adjustable peg system was established. Exchange rates were fixed against gold but since there were fixed dollars of gold (35 per ounce) the fixed rates were expressed relative to the dollar.
- The dollar became the principal international reserve asset.
- Only the USA undertook to convert their currency into gold if required.
- In the 1950's the US held the largest gold stocks in the world. Thus the **dollar became "as good as gold**" and countries were willing to use the dollar as their principal – This is the reason why the dollar is a vehicle currency.
- The international trade grew termed as "golden age of capitalism", but the system collapsed in 1971.

ANY QUESTIONS!

Sisi Ambao Tunafunzwa Na Ulimwengu Tunafungua Lini Shule?

😂😂😂😂😂

Mm naona kila sku tuko shule 🤣🤣

CURRENT EXCHANGE RATE SYSTEMS ! (1973 TO PRESENT)

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- In 1973 Flexible exchange rates were declared by 14 countries and allowed their currencies to float against the $.

- The regime was ratified by the **Jamaica Agreement** (January 1976) – where a *new set of rules for the international monetary system to achieve exchange rate stability was established.*
  - ***B*****ut allowing every country to choose the best arrangement for them.**

CURRENT EXCHANGE RATE SYSTEMS ! (1973 TO PRESENT)

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- Therefore the exchange rate can be **determined in different ways** referred as to exchange rate regimes.
  - **The exchange rate regime** represents the system or methods through which the exchange rate are determined or established around countries of the world.
- Different countries of the world apply and implement different approaches in determining the value (price) of their currency relative foreign currencies.

- The countries are supposedly required to decide on the suitable exchange rate system – it can substantially influence *international trade volume*, flow of foreign investment and capital.

The Current Exchange Rate Regimes!

- **Flexible (floating) Exchange Rate regime** allows the exchange rate to be determined by market forces of demand and supply of currencies, such that the increased demand for a particular currency, other things remaining constant, will lead to its appreciation and increase in its price relative to other currencies.
  - Trade and capital flows are the main factors affecting the exchange rate
  - In the long run, it is the macro economic performance of the economy (including trends in competitiveness) that drives the value of the currency)
  - No pre-determined official target for the exchange rate is set by the government.
- It is rare for pure free floating exchange rates to exists – most governments at one time or another seek to “manage” the value of their currency through changes in interest rates and other controls.

The Current Exchange Rate Regimes!

- **Managed floating regime -** also referred as dirty float or hybrid exchange rate system. Under this system the exchange rate is ***allowed to fluctuate according to market forces*** but with irregular and untimely interventions by countries' authorities.

- **Fixed exchange rate system – the** government maintain a fixed exchange rate at which it desires its currency to be exchanged against foreign currencies. Under this approach the central bank of the country sets a fixed value at which its domestic currency will be traded again.st the rest of the currencies.

The Current Exchange Rate Regimes!

- **Pegged currency -** In some cases where a particular country have regular transactions denominated in particular foreign currency (ies), that country may decide to peg or fix the value of its currency against the selected foreign currencies.
  - E.g. Namibia and SAR. This is called the pegged exchange rate arrangement where the value of the country is attached or fixed to another foreign currency or to a basket of foreign currencies.

- **Parallel exchange rates - S**ome countries set different exchange rates for different types of transactions e.g. trade and tourism. Official exchange rate may be set without regard to market forces and this will lead to individual setting up non official markets.

Exchange Rate Regimes Applicable in Tanzania!

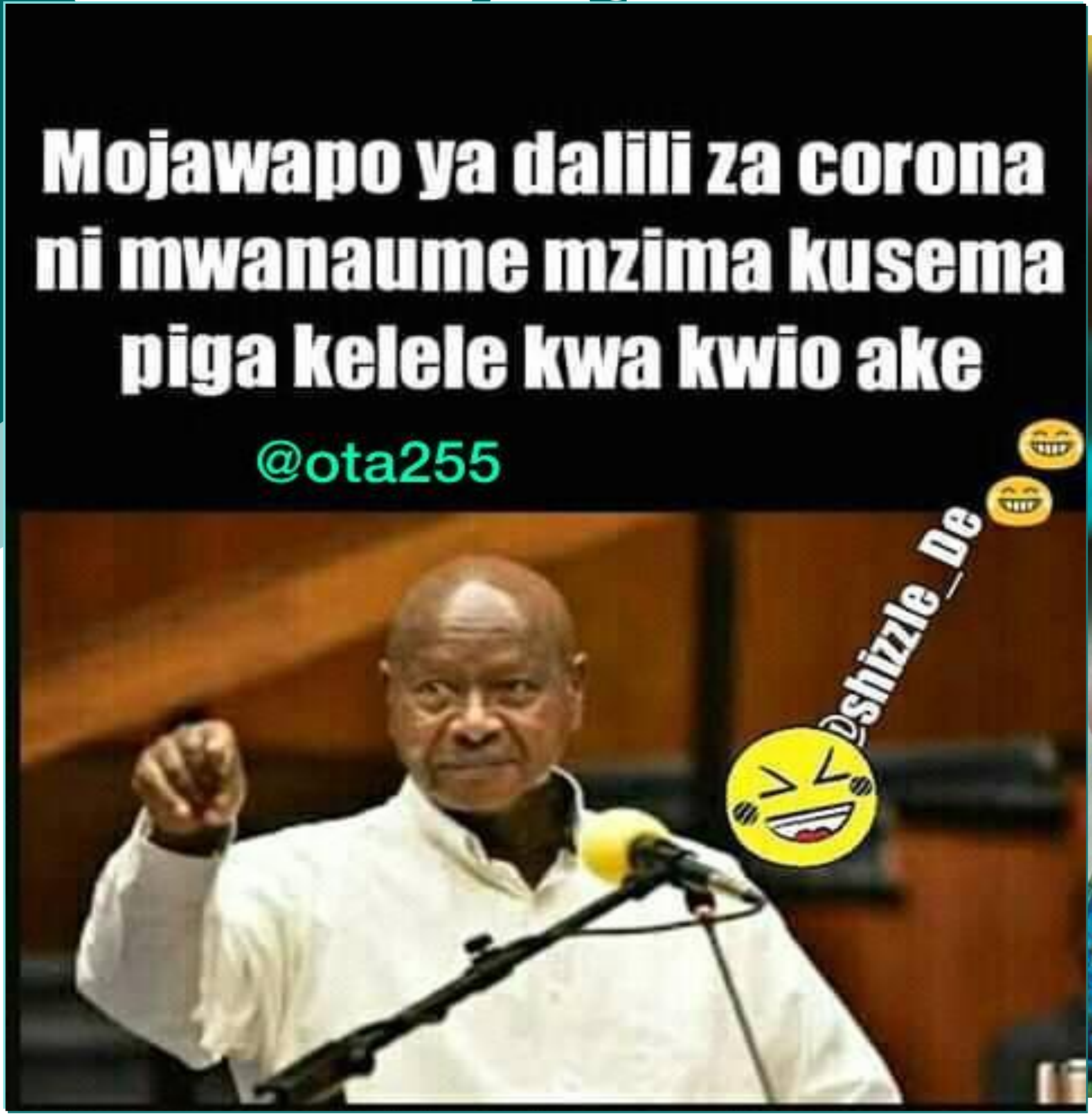
- Similar to most of developing countries in the world, Tanzania operates under the **floating exchange system** which was adopted around 1990's.
  - The exchange rate between Tanzanian Shillings (TZS) and foreign currencies is therefore determined by the domestic inter-bank currency transactions, that is demand for and supply of the TZS in the foreign exchange market.
- It is discussed before, however, that it **almost impossible** to operate under a purely freely floating exchange rate system and therefore most of countries use hybrid system.
  - Therefore the exchange rate is market determined but with irregular foreign exchange intervention aiming at moderating the rate of volatility and undue **fluctuations** in domestic currency's value.

Exchange Rate Regimes Applicable in Tanzania!

- The depreciation of the value of Tanzanian shillings (TZS) against major currencies of the world such as US dollar ($), Euro (€), Sterling pound (£), have continuously witnessed over the recent past.
  - For example the weight average exchange rate between Tanzanian Shillings and US dollar have changed from TZS 1280.30 (January, 2009) to TZS 2241.66 (January, 2018).

- This depreciation could substantially be associated (i) high heavy reliance on imports and low volumes of exports (balance of payments deficit) (ii) decreasing level of exports of agricultural products such as sisal, cotton, cashew nuts, and (iii) the fall in world prices of agricultural commodities.

Any Questions Please?



WHATS MORE?!

- **Explore the operation of single currency system (its possibility, advantages and drawbacks).**
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- A number of economic blocks in Africa, including the East African Community, are now **considering having a single currency** in the future.
  - **Required:**
  - Using examples, briefly **discuss the importance** of a "single currency" for African economies.
  - Highlight **key factors** that must be considered before embarking on a single currency.

Ready ?,ANY QUESTIONS

 DISCUSS FACTORS AFFECTING THE VALUE OF TANZANIAN SHILLINGS, SUGGEST THE CURE for DETERIORATING VALUE OF TZS%

BLESSED………………

Asante!, Thank you!, Obrigado!, Merci!, Cheers!.

End of presentation