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Business

A system to cut exchange rate risks by 40pc

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Right, Jesper Toft, founder of the Global Currency Union, poses with GCU partner Martin Plambek. GCU

Bangladesh can reduce exchange rate fluctuation risks by around 40 percent if it adopts a trade-weighted system developed by a Danish firm.

The multi-currency exchange rate system, developed by the Global Currency Union (GCU), will enable Bangladesh to reduce exchange rate volatility of $350 million annually on average against its trading partners, said Jesper Toft, chief executive of the GCU.

A self-balancing market-determined system, it ensures adjustment to ongoing changes in both currency values and trade patterns, thus ensuring optimal stability for the country that employs it without requiring the sort of interventions demanded by a pegged or managed exchange rate regime.

The system requires no intervention from the central bank to maintain optimal stability.

The excessive movement in the exchange rates will be balanced out and subdued by the currencies in the system.

It will reduce the currency rate volatility by allowing countries to settle their cross-border payment obligations electronically.

"By using the trade volumes and relative currency values, the system will provide the best-achievable stability for monetary value, trade and investment while still being dynamic," Toft told The Daily Star in an interview in Dhaka last week.

The implementation of the GCU rate system will not interfere with any central bank's matters such as setting interest rates or money supply or with the way commercial banks buy and sell currencies, Toft said.

The GCU rate system provides optimal exchange rate stability by taking trade patterns into the equation through the use of a proprietary method.

The implementation is possible for each individual sovereign nation with or without coordination with other nations, he said.

Toft said the taka is pegged against the dollar, meaning the country's currency does not have exchange rate stability against other currencies.

The pegging to the dollar gives stability only to 9 percent of Bangladesh's total trade, with the remaining 91 percent still exposed to risks, he said.

"If you can diversify yours risks, you will have better stability. We may not be able to eliminate swings entirely, but we will be able to keep it stable."

Countries like Bangladesh can greatly benefit from the system in case of exchange rate stability as it will provide the most stable exchange rate, he said, adding that it will also contribute to economic development and financial stability.

The Danish entrepreneur also said the system will eliminate the need to buy currencies to keep the exchange rate stable.

Last year, Bangladesh Bank bought $2.5 billion to keep the taka stable.

Toft said the information about the system has been distributed to 86 countries.

Bangladesh can launch a project to learn about the system before deciding whether it would accept or reject the system. Countries joining the system would be part of a governing body to operate the system, he said.

The current global currency exchange system is outdated, and Christine Lagarde, managing director of the International Monetary Fund (IMF), has also admitted the shortcomings in the global currency exchange rate system, Toft said.

On the sidelines of the World Bank-IMF meeting in Washington on Thursday, Lagarde said the world still does not have a good system for helping countries in times of turmoil, as evidenced by recent exchange rate fluctuations and large capital flows and reserve accumulation in some emerging markets.

Excessive reliance on currency depreciations to boost domestic economies could exacerbate global tensions over exchange rates, she said.

The IMF also said the currency shifts are helpful on the whole, as they support the struggling economies in the eurozone and Japan, but also create winners and losers.

“This is exactly the problem the GCU Multi Currency Exchange Rate system solves,” said Toft.

With the help of two university professors, Rolf Poulsen, a professor of the Department of Mathematical Sciences at University of Copenhagen, also analysed the gains for Bangladesh, along with Greece, Denmark and Turkey, if it introduces the GCU system.

In a paper they said if the currency peg regime is changed in Bangladesh it will be to the disadvantage of some countries, but from an overall perspective there will still be an advantage, as the overall trade volatility will be markedly lowered.

“In short, there are strong gains from diversification. Looking at the more conservative measure of insurance costs, the gains are smaller but still clearly visible.”

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The paper said using trade weights to construct the basket would lower economy-wide insurance cost against Bangladesh's top eight trade partners from 1.74 percent of the trade balance to 1.55 percent, which, given the size of Bangladeshi economy, corresponds to $119 million.

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